500-09-021691-118 – 500-09-021692-116
500-09-021693-114

QUEBEC COURT OF APPEAL

(Montreal)

On appeal from a judgment of the Superior Court, District of Montreal, rendered on April 14, 2011 by the Honourable Madam Justice Marie St-Pierre.

No. 500-05-001686-946 S.C.M.

ELLIOT C. WIGHTMAN ET AL.
[SEE ANNEX A]

APPELLANTS
(Defendants)

v.

THE ESTATE OF THE LATE
PETER N. WIDDRINGTON

RESPONDENT
(Plaintiff)

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(Preliminary Version)

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Defendants

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APPELLANTS' ARGUMENT

INTRODUCTION

1. This appeal raises the issue of whether Coopers & Lybrand Chartered Accountants ("C&L") and its individual partners (collectively the "Defendants"), as auditor to Castor Holdings Ltd. ("Castor"), are liable to one of Castor's directors, the late Peter N. Widdrington ("Widdrington"), for amounts payable for his alleged defaults as a director and for the monies he invested in Castor allegedly in reliance on certain C&L representations.

2. The present appeal arises in a complex, unprecedented procedural setting briefly explained in paragraphs 30 ff. of the Judgment.[1] This unprecedented setting resulted in the involvement of numerous additional plaintiffs from other "Castor actions", and the introduction of "common issues" which will be decided, in a binding manner, in the present case for all other Castor actions.[2] The situation was described by the trial judge as a "Herculean" challenge.[3] In addition, as a result of the premature interruption of the first trial and time constraints on the second trial, much of the Plaintiff's evidence was by transcript and the trial judge relied on unsworn written expert reports.

3. On the "common issues", the Court declared:[4]

- that the governing law is Quebec civil law;

- that the audited consolidated financial statements of Castor are materially misstated and misleading for the years 1988, 1989 and 1990 and that C&L failed to perform their duties as auditors for the same years;

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1 §§30-36 ("§" refers to paragraphs of the Judgment).
2 Cf. judgment of A. Wery, J. dated October 16, 2006.
3 §21.
4 p. 750 of the judgment.

- that, in the same period, C&L issued various other faulty representations (Valuation Letters and "Legal-for-Life Certificates", collectively with the auditor's reports on the financial statements, the "C&L Representations").

4. On issues specific to the Plaintiff, the trial judge found:

- that Widdrington committed no fault in the exercise of his duties as a director of Castor, nor in the due diligence he exercised prior to making his respective investments in Castor;[5]

- that it was reasonable for Widdrington to rely on C&L's Representations.[6]

SUMMARY OF THE APPEAL

5. The Defendants respectfully submit that these findings should be reversed (and Widdrington's claim dismissed) as they arise from multiple errors, of various nature, based on the following overriding errors of law:

   a) applying Quebec civil law as the *lex loci delicti*[7] contrary to the principles enunciated by the Supreme Court of Canada in *Tolofson*[8] and subsequent authorities addressing the place of the delict as the place of the prejudice (the "*Lex Loci Delicti*" Issue);

   b) failing to apply the law of the corporation (*lex societatis*), namely New Brunswick law, to the liability of the auditor appointed to hold corporate office (the "*Lex Societatis*" Issue);

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5 §3343.
6 §3340, §3534.
7 §§3381-86.
8 *Tolofson* v. *Jensen*, [1994] 3 S.C.R. 1022 ("*Tolofson*").

c) finding an exception to limits on auditor's liability that is inconsistent with the principles enunciated by the Supreme Court of Canada in *Hercules*[9] (the "*Hercules*" Issue);

d) finding that under Quebec civil law, a professional who issues an opinion is liable to anyone who happens to rely on it (irrespective of whether he was an intended recipient or whether he used it for the purpose for which it was prepared), contrary to the principles enunciated in the *Houle*[10] and *Bail*[11] decisions of the Supreme Court, and as found by this Court in *Savard*;[12]

e) relying on the subjective test of the "outside directors" to excuse the conduct of Widdrington in the discharge of his duties as director, contrary to the Supreme Court of Canada decision in *Wise*[13] which held that the applicable test is an objective one and by allowing Widdrington to shift liability for his own negligence (the "Directors' Duties" Issue);

f) determining that a sophisticated investor such as Widdrington who failed to obtain important information not revealed by the relevant audited financial statements or Valuation Letters that his advisors had urged him to obtain before making his investments, can be said to have reasonably relied on said audited financial statements or Valuation Letters, rather than being held the author of his own misfortune (the "Sophisticated Investor" Issue);

g) relying on inadmissible, unsworn evidence in experts reports by deeming them read into the record although they were neither affirmed under oath nor always consistent with the sworn evidence (the "Read-in Rule" Issue);

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9 *Hercules Management Ltd.* v. *Ernst & Young*, [1997] 2 S.C.R. 165 ("*Hercules*").
10 *Houle* v. *Canadian National Bank*, [1990] 3 S.C.R. 122 ("*Houle*").
11 *Bank of Montreal* v. *Bail Ltée*, [1992] 2 S.C.R. 554 ("*Bail*").
12 *Savard* v. *2329-1297 Quebec inc.*, (2005) R.J.Q. 1997 (CAQ) ("*Savard*").
13 *People's Department Stores inc.* v. *Wise*, [2004] 3 S.C.R. 461 ("*Wise*").

h) applying incorrect accounting principles and auditing standards and by misinterpreting the true nature and purpose of the Valuation Letters and Legal-for-Life Certificates contrary to the applicable rules (the "Negligence" Issue);

i) holding partners jointly and severally liable for the alleged negligence of their civil partnership,[14] contrary to article 1854 CCLC, as found by the Supreme Court of Canada in *Pérodeau*[15] (the "Solidarity" Issue);

j) failing to deduct from the calculation of Plaintiff's damages the benefits Widdrington derived from his investment in Castor as well as erroneously condemning Defendants to pay interest and additional indemnity on certain amounts (the "Damage" Issue);

k) holding Defendants liable for extraordinary costs,[16] neither incurred by nor the responsibility of the Plaintiff and, in fact, incurred by and for plaintiffs in other outstanding, undetermined Castor actions, without properly considering the principles governing her judicial discretion (the "Cost" Issue).

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14 §§3597-3603.

15 *Pérodeau* v. *Hamill*, [1925] S.C.R. 289.

16 §§3607, 3639 and pp. 751-52 of the Judgment.

PART I – THE FACTS

A) PARTIES

1) Widdrington: Experienced, Educated, Sophisticated, Supported

6. Widdrington received a superior education providing a strong foundation for his highly successful business career as a senior executive, experienced director and sophisticated investor.

a) He obtained his undergraduate degree in Economics with honours from Queen's University in 1953 and, subsequently, a M.B.A. from the Harvard Business School in 1955;[17]

b) At the time of his introduction to Castor, Widdrington was a successful Ontario businessman approaching retirement. He was President and CEO of John Labatt's Ltd. ("Labatt") from 1973 until 1989 and Chairman of the board from 1987 to 1991. He had been involved in the acquisition of numerous companies and had a comprehensive understanding of financial statements as well as an ability to evaluate a wide variety of business situations and investment opportunities;

c) From 1981 to 1987, Widdrington was a member of Labatt's audit committee.[18] This provided him with first-hand experience with the preparation and audit of financial statements;[19]

d) Widdrington was also a member of the board of some 20 companies during his career, including many that were in the business of lending and familiar with Canadian real estate, such as the Canadian Imperial Bank of Commerce (1986-

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17 §3118; PW-12-1.
18 §3122.
19 §3123.

2001), Canada Trust Co. Mortgage Company (1977-1986), Olympic Trust of Canada (1983-1999), Huron & Erie Mortgage Corporation, Trinity Capital Corporation ("Trinity") (1987-1992), Toronto Blue Jays Baseball Club (1991-1996), Brascan (1979-1994) and the SNC-Lavalin Group Inc. (1991-1999).[20]

7. For his personal investments and his directorships, Widdrington relied on a team of competent and experienced advisors composed of Heinz Prikopa ("Prikopa"), George Taylor ("Taylor") and Bill Wood ("Wood"):

a) Prikopa, who had an accounting background, worked for Labatt from 1982 to the fall of 1991 in the Finance and Pension Plan departments.[21] He provided Widdrington with written monthly reports on all the material he received involving tax matters, investments, and relating to Widdrington's directorships.[22] When Prikopa left Labatt in 1991, Widdrington paid him $1,000/month and charged the invoices back to Labatt. When Widdrington testified at trial, Prikopa was still handling his personal affairs for remuneration;[23]

b) Taylor was trained in accounting and served as Vice-President Finance for Labatt's parent company before becoming Labatt's CEO.[24] He had extensive experience in the analysis of financial statements. He provided Widdrington with general advice on tax and investment matters;[25]

c) Wood is a Chartered Accountant and was the Ernst & Young engagement partner responsible for the Labatt audit. Widdrington relied on him for tax and financial

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20 §3125.
21 §3130.
22 §3136.
23 §3137.
24 §§3141-44.
25 §3147; Taylor, Jan. 20, 2005, pp.15-26; Widdrington, Nov. 29, 2004, pp. 75-77.

planning, not only for himself but also for his wife and daughter. Wood also provided advice to Widdrington on personal investment matters.[26]

8. Widdrington invested \$1.1 million in Castor in December 1989 to become one of its directors. He further invested \$0.3 million in October 1991, in response to a cash call from Castor to overcome a liquidity crisis.

9. At all material times Widdrington lived and worked in Ontario. He was represented by the lawyers for Castor's Trustee in bankruptcy who had acquired an interest in Widdrington's claim immediately prior to the first trial. Widdrington died prior to the start of the second trial and the claim was continued by his estate.

2) C&L – an Ontario Partnership

10. At the relevant time, C&L was an Ontario partnership of chartered accountants composed of some 200 individual partners, carrying on business as auditors from numerous offices across Canada.

B) CASTOR

1) Structure

11. Castor was a private, unregulated corporation whose shares were not publicly traded. It was the parent company of an international group of companies carrying on business as niche lenders to developers of real estate (the "Castor Group"). Its directing mind, Chairman, President and CEO was Wolfgang O. Stolzenberg ("Stolzenberg").[27]

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26 §3184.
27 §§6-9, 44, 45.

12. Castor was incorporated in New Brunswick and continued under the *New Brunswick Business Corporations Act* (the "Act"). It is to be noted that:[28]

a) as required by s. 17 of the Act, Castor's registered office was in New Brunswick (Saint John). As permitted by s. 13, Castor had an "executive" office in Montreal and offices in Calgary and Toronto;[29]

b) as authorized by section 99 of the Act, Castor's shareholders were governed by a unanimous shareholders agreement which provided for restrictions on the transfer of Castor's shares.[30]

13. The Act establishes a statutory regime for corporate governance, including various offices with statutory duties.

2) Castor's Directors

14. Under the Act, the affairs of Castor are overseen by its directors.[31] Section 79(1) of the Act reads as follows:

> *"79(1) Every director and officer of a corporation in exercising his powers and discharging his duties shall*
>
> *(a) act honestly and in good faith, and*
>
> *(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances*
>
> *in the best interests of the corporation."*

15. From March 1990 until the end, Widdrington was a director of Castor.

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28 R.S.N.B. c. 9.1 (PW-2312-1).
29 §8; PW-2312-1, s. 13 and 17.
30 PW-2312-1, s. 99; "Restated Shareholder Agreement" dated May 10, 1988 (PW-2382).
31 PW-2312-1, s. 60.

3) Directors' Financial Statements

16. Under Part X of the Act, entitled "*Financial Reporting*":

a) by section 100, the directors must place before the shareholders at every annual meeting, comparative financial statements which must be prepared in accordance with "*generally accepted accounting principles*" ("GAAP");[32]

b) by section 102, the directors of a corporation must approve these financial statements (evidenced by the signature of at least one of them) before they are issued, published or circulated.

17. GAAP indicate that financial statements are prepared for a reader who has a reasonable understanding of business, economic activities and accounting, and a willingness to study the information with reasonable diligence.[33]

18. As envisaged by GAAP, Castor prepared its financial statements, and made the GAAP decisions relating thereto.[34] In this case, those responsibilities were discharged by Messrs. George Dragonas ("Dragonas"), Socrates Goulakos ("Goulakos") and Stolzenberg,[35] none of whom testified.

19. As permitted by s. 101 of the Act, Castor consolidated its financial statements with the separately audited or inaudited financial statements of Castor's international group of subsidiaries. By 1990, Castor's offshore subsidiaries accounted for approximately 55% of its assets, half of its loan portfolio and 73% of its reported earnings.[36]

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32 In Canada, the primary source of GAAP is the Handbook published by the *Canadian Institute of Chartered Accountants* (PW-1419-2).

33 Handbook, s.1000.16; (PW-1419-2).

34 §§271-2.

35 R.B. Smith, May 14, 2008, pp. 87-88.

36 PW-5-A and PW-5-1.

4) Auditor a Corporate Office

20. By section 105 of the Act, the shareholders may appoint an auditor (which by section 1(1) may be a partnership) to hold office until the close of the next annual meeting. Throughout the relevant period, Castor's shareholders appointed C&L to hold the office of the corporation's auditor.[37]

5) Statutory Audit

21. By section 110 of the Act, the auditor of the corporation shall make the examination that is, in his opinion, necessary to enable him to report on the financial statements required by the Act.

22. In Canada, the standards for such review are set out in the Generally Accepted Auditing Standards ("GAAS").[38]

23. By section 110 of the Act, the auditor can rely on other audits of statements to be consolidated.

24. As Plaintiff's experts Keith Vance ("Vance"), Kenneth Froese ("Froese") and Lawrence Rosen ("Rosen") testified, under GAAS, as long as the final decision of management is in accordance with GAAP, the auditor cannot impose upon management his own judgment, estimates or preference, as between acceptable alternatives ("Two schools of thought").[39] Nor can the auditor oblige his client to disclose more than GAAP

37 §104.
38 GAAS are set out in the CICA Handbook (PW-1419-2A).
39 D-964, Vance, May 12, 2008, pp. 153-54, May 26, 2008, pp. 148-51, March 4, 2008, pp. 99-101, May 4, 2010, pp. 137-38; D-1260, esp. pp. 192-93, D-1263, esp. pp. 145-47; D-1263-2; Rosen, Feb. 25, 2009, pp. 75-76; Apr. 7, 2009, p. 76; Froese, Nov. 11, 2008, pp. 232-33.

requires.[40] Audits are conducted on the fundamental assumption of management's good faith, and could not be conducted otherwise.[41]

25. Auditors date their opinion on the date of "substantial completion" of the financial statements and audit work, and this is the last date on which they actively seek evidence.[42] Each audit at issue in this litigation was completed in February following Castor's year end.[43] GAAP and GAAS preclude consideration of events or information thereafter ("hindsight").

6) Castor's Business

26. Castor had two main clients in North America that were involved in the development of various types of real estate: York-Hannover ("YH") and D.T. Smith ("DTS").[44]

27. Castor's strategy was to support such developers until their developments were sufficiently advanced to be sold or refinanced to repay Castor ("preserve and protect").[45] This led to three business practices common to this type of lending:

a) capitalization of the interest revenue accruing on Castor's loans;[46]

b) short term loans (i.e. normally maturing within one year), with an expectation that the loans would be renewed on appropriate terms and supported until the underlying project could be sold or refinanced (regular review);

40 Vance, May 28, 2008, pp. 249-50.
41 Vance, Apr. 16, 2010, p. 33.
42 Handbook, s. 5405.3, 5405.04, 5405.05, 5405.06.
43 PW-5-1, tabs 88A, 89A and 90A.
44 The evidence did not cover Castor's or Castor Group's loan portfolios as a whole.
45 R.B. Smith, May 14, 2008, pp. 126, 175-76, May 15, 2008, pp. 247-49, May 16, 2008, pp. 46-48.
46 The concept of capitalized interest revenue, its prevalence and acceptability among Canadian lenders, particularly in loans to real estate developers, is stated in the quote from the Estey Commission Report found at §732.

c) at least annual renegotiations which considered the security, additional support and the reallocation of the increased loan balances of some to other loans or borrowers within the same borrowing group ("cross-collateralization").

28. During the 1980's, the North American real estate market and Castor prospered. Castor obtained funding from its shareholders and creditors to grow and to maintain its "preserve and protect" strategy.[47]

7) Castor's Collapse

29. At the beginning of the 1990's, after a decade of unprecedented increases in real estate values, the real estate market began a precipitous decline. The length and depth of the market's decline was not generally noted until afterwards, and most Canadian lenders only began taking loss provisions relating to declines in value in the real estate that backed their loans in and after 1992.[48]

30. In September 1991, Stolzenberg requested an increase of the capital base of Castor of $25 million.[49] In October 1991, in support of further requests for greatly increased amounts, Stolzenberg announced to the board that Castor was faced with liquidity problems, as for the first time in its history its traditional funding sources were being discontinued.[50]

31. In February 1992, despite continuing to meet its obligations, Castor sought creditor protection and later in July 1992, one of Stolzenberg's companies petitioned Castor into bankruptcy.[51]

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47 R.B. Smith, May 14, 2008 pp. 126, 175-76, May 15, 2008, pp. 247-49, May 16, 2008, pp. 46-48.

48 Rosen, Apr. 7, 2009, pp. 138-41; Selman, May 5, 2009, pp. 145-46, 156-57, 221-22; D-659-1 re 3.01) B, C, D; Goodman, Oct. 30, 2009, p. 156, Oct. 8, 2009, pp. 111-20, 122.

49 PW-17.

50 PW-51.

51 PW-21, PW-26.

8) Castor's Records Contaminated

32. Prior to Castor's Trustee in bankruptcy ("the Trustee") taking control of Castor's Montreal premises, documents were shredded and others were shipped overseas.[52] Over the following years, the Trustee collected records from various third parties including YH's trustee in bankruptcy. At trial, the Trustee was unable to affirm which of "Castor's documents" produced at trial were found in Castor's files at the relevant times or at all.[53]

33. While Vance tried to reconcile Castor's accounting records, he did not consider Castor's other business records[54] and the Defendants identified numerous important documents which could not be found.[55] One misplaced appraisal caused Vance to revise his opinion on one loan by up to $80 million. Other YH documents could not be identified.[56]

34. None of the Plaintiff's experts could recreate the audits in question nor did they try.[57]

C) C&L AS CASTOR'S AUDITOR

1) C&L Engagement

35. Castor contracted with C&L to perform its statutory audit.

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52 R.B. Smith, Sept. 17, 2008, pp. 23-24; video produced as D-644 & D-941; Gourdeau, Feb. 18, 2008, pp. 270-79; Feb. 19, 2008, p. 190; Jan. 14, 2008, pp. 96-97; Vance, Apr. 17, 2008, pp. 74-76.

53 Gourdeau, Jan. 30, 2008, pp. 76-77, Feb. 19, 2008, pp. 202-17, Feb. 22, 2008, pp. 61-63; Vance, Apr. 17, 2008, pp. 100-02, Apr. 18, 2008, pp. 83-85.

54 Vance, May 5, 2010, pp. 75-79.

55 *Cf.*, *infra*, para. 372 and footnote 424.

56 Vance, Apr. 21, 2008, pp. 30-31, 34-37, 41-44, 92-95, 169-71, Apr. 18, 2008, pp. 83-85, July 7, 2008, pp. 95-99.

57 Froese, Dec. 3, 2008, pp. 107-12; Rosen, Apr. 7, 2009, pp. 143-51, Feb. 20, 2009, pp. 236-37; Vance, Apr. 18, 2008, pp. 54-59, June 4, 2008, pp. 38-39.

36. On January 14, 1988, C&L's engagement partner for Castor, Elliott C. Wightman ("Wightman"), wrote to Stolzenberg, under C&L's "*policy to periodically restate the scope of our statutory audit every five years for the benefit of our mutual understanding*",[58] that:

> "*We are required by statute to report to the shareholders as to whether, in our opinion, the annual financial statements give a fair presentation of the financial position and results of operations of the company in accordance with generally accepted accounting principles applied on a consistent basis. Our examination is designed for this purpose and, in accordance with generally accepted auditing standards, will include an examination of the accounting system, internal controls and procedures. The extent of the examination will depend upon our assessment of the accounting system and the related internal controls.*
>
> *The procedures normally used in the course of an examination conducted in accordance with generally accepted auditing standards often disclose irregularities which would have a significant effect on the financial statements but this may not always be so, because of the methods by which the irregularities are committed or concealed.*
>
> *The foregoing relates only to our statutory responsibilities and we are always prepared to extend the scope of our examination if you so desire.*"

37. Castor never requested that the scope of C&L's examination be extended.

2) C&L's Audits

38. In accordance with the Act and C&L's engagement, audits of Castor's financial statements were conducted annually.[59]

39. C&L's audit opinions were based on its audit tests. In accordance with GAAS, C&L relied on Castor's documents, management's representations and confirmations from

58 PW-1053-5A-1.
59 PW-1053-5A-1; PW-2312-1.

various Castor creditors and customers (some of whom are plaintiffs in the Castor litigation).

40. For purposes of the audit of Castor's consolidated financial statements, C&L's personnel audited the financial statements of Castor and some of its foreign subsidiaries and performed tests on transactions in some other subsidiaries.[60] Some of this audit work was conducted in Europe (Switzerland, Liechtenstein). For one of Castor's foreign subsidiaries, C&L relied on audits by another auditor as authorized by section 110 of the Act.[61]

3) C&L's Audit Opinion

41. The C&L audit opinion stated that, based on its examinations, the consolidated financial statements prepared by Castor for the particular year "*present fairly [Castor's financial situation] in accordance with GAAP*".[62]

42. The audit reports were addressed to Castor's shareholders and entitled "Auditors' Report to the Shareholders".[63] They were delivered to Castor's Chairman for use at the annual meeting of Castor's shareholders as required under the Act and engagement agreements.[64]

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60 Audit opinions were issued by C&L for: Castor (consolidated and unconsolidated) PW-5-1, PW-5A), CH International (Netherlands) B.V. (consolidated) (PW-1053-67-3, PW-1053-67-4, PW-1053-67-5), CH International Finance N.V. (unconsolidated) (PW-1053-87-18, PW-1053-86, PW-1053-86-1). C&L conducted tests for purposes of consolidation on transactions of CH International (Overseas) Ltd., CH International (Cyprus) Ltd. and Castor Finanz AG, but provided no opinion.

61 C&L Ireland audited CH (Ireland) Inc.: Cunningham, Nov. 24, 1998, pp. 36-39; PW-508.

62 PW-5-1, tabs 88A, 89A, 90A.

63 PW-5-1.

64 PW-2312-1; PW-1053-5A-1.

4) Share Valuation Letters

43. Castor's Restated Shareholder Agreement[65] provided for a "valuation report" on Castor's common shares by the auditor of the corporation:

> *"'valuation report' means the report of the auditors of the Company as to the fair market value of the equity shares of the Company as of the financial year end of the Company and reported to the shareholders at the annual meeting next following such year end, which report shall be prepared on a basis consistent with the assumptions used in prior years and shall be final and binding upon the parties'*[66]

44. At Castor's request, C&L issued 2 such Valuation Letters each year prepared on a consistent basis using assumptions established in 1980[67] – one by early March using the last audited statements, and one in or around October replicating the methodology using Castor's unaudited second or third quarter statements.[68]

45. For the relevant period, each Valuation Letter was addressed and delivered to Stolzenberg for the Directors[69] and stated:

> *"You have asked us as auditors and professional accountants to assist you in establishing the fair market value of the common shares of Castor Holdings Ltd. (Castor) on or about [a given date]. The purpose of this valuation is to update previous letters relating to the valuations of shares of Castor prepared at various dates and for the information of the directors."*[70]

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65 PW-2382.
66 PW-2382, p. 4.
67 PW-6-1.
68 PW-6-1.
69 PW-6-1.
70 PW-6-1.

46. For his investments of December 1989 and October 1991, Widdrington saw the most recent semi-annual Valuation Letters based on Castor's unaudited interim financial statements.[71]

5) Legal-for-life Certificates and Opinions

47. At the request of Castor, its lawyers issued Legal-for-Life opinions as to whether it was permissible for various regulated investors (such as insurance companies, pension funds, trustees, etc.) to hold Castor shares or notes under various statutory requirements (which have since been abrogated in most jurisdictions, including Quebec) ("Legal-for-Life opinions").[72]

48. At Castor's request, C&L, as Castor's auditor, provided Castor's lawyers with certification of certain financial ratios calculated from Castor's historic financial statements ("Legal-for-Life Certificates").[73]

49. Widdrington did not obtain or see any C&L Legal-for-Life Certificates. He testified that, after he became a director of Castor, he saw in passing Legal-for-Life opinions in the director's books.[74]

D) WIDDRINGTON AND C&L

50. None of the aforesaid C&L Representations were prepared or issued for Widdrington personally, or for any investor, creditor or for any specific transaction. C&L did not have any dealings or understanding with Widdrington or knowledge of his investments or director's decisions.[75]

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71 PW-10, PW-18. The Valuation Letters did not address debentures, preferred shares or units forming part of Widdrington investments.
72 PW-20.
73 PW-7, PW-1053-5A, et seq. pp. 219-20.
74 Widdrington, Nov. 30, 2004, pp. 140-41, 162.
75 Wightman, Feb. 10, 2010, pp. 119-21, 149.

E) WIDDRINGTON AND CASTOR

1) Widdrington's Stolzenberg Connections

51. Widdrington first met Stolzenberg in January 1986 at a symposium for influential executives in Switzerland. He described Stolzenberg as "*very smart*" and "*a great salesman*" with a strong ability to "*work the room*".[76] Plaintiff's expert Stephen Jarislowsky ("Jarislowsky") described Stolzenberg as having a reputation as a brilliant and respected financier.[77]

52. Over the next 3 years, Widdrington took steps to develop a relationship with Stolzenberg through meeting him for lunches and dinners[78] and inviting him to several private Labatt functions at which outsiders were not normally present.[79]

53. In August 1986, Widdrington arranged for Stolzenberg to meet Taylor to discuss the possibility of Labatt's Pension Funds investing in Castor. Stolzenberg made a presentation to Taylor, described Castor's business strategy and performance and provided him with Castor's financial statements.[80]

54. In January 1987, Widdrington, then a director of the CIBC, asked CIBC's CEO for information on Castor and obtained information on Castor from CIBC's Senior Vice-President.[81]

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76 §§3185-87.
77 Jarislowsky, Apr. 4, 2005, pp. 44-45.
78 §§3188, 3196, 3197, 3198.
79 §3196.
80 §§3189, 3190.
81 §3191-2; PW-2377

2) Widdrington joins Stolzenberg at Trinity

55. In 1987, Widdrington joined Stolzenberg and other Castor insiders on the board of directors of Trinity, a company indirectly owned in part by Stolzenberg, which borrowed extensively from the Castor Group.[82]

56. By 1992, Trinity had borrowed approximately $14 million from Castor's subsidiaries, which provided more than 95% of Trinity's funding.[83] At Trinity, no officer could borrow money for the account of Trinity without the specific approval of the board of directors.[84]

57. By the time Widdrington made his equity investment in Castor in December 1989, he had been a director of Trinity for slightly over a year and a half and, as such, he was aware of Trinity's borrowings from Castor subsidiaries, as he finally admitted at trial.[85]

3) Widdrington pursues Stolzenberg

58. Later in 1987, Widdrington invited Stolzenberg to attend Labatt's annual meeting. Stolzenberg was the only outsider invited.[86]

59. During 1988, Widdrington had several more meetings, lunches, dinners and contacts with Stolzenberg, including at a Castor board of directors' dinner and at Labatt's annual meeting.[87]

60. In 1988, Widdrington introduced Stolzenberg to Canada Trust.[88]

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82 Binch, Oct. 30, 2001, pp. 198-202; The minutes of the board of directors of Trinity Capital Corp.: D-596, D-599, D-600, D-602, D-603, D-606, D-608, D-609, D-610, D-613.
83 Binch, Oct. 30, 2001, pp. 198-202.
84 D-594;
85 Widdrington, Dec. 17, 2004, pp. 143-44.
86 §3196.
87 §3197.
88 §3197.

4) Widdrington invests in Stolzenberg

61. In October 1988, during a flight to a Trinity board meeting on Stolzenberg's private jet, Widdrington asked Stolzenberg if he could find a short-term investment vehicle for him.[89] This was confirmed by a short letter dated October 11, 1988,[90] accompanied by his cheque payable to Castor, which reads:

> *"Dear Wolfgang:*
>
> *As per our discussion of last week, enclosed please find my cheque in the amount of $200,000.*
>
> *Once you have had an opportunity to do so, for my own record keeping purposes, I would appreciate it if you would let me know how the money is being invested."*

62. This investment in a Castor promissory note was renewed from time to time and eventually became part of Widdrington's investment in Castor in December 1989.[91]

63. Widdrington had not seen any financial information regarding Castor prior to making this $200,000 investment.[92]

5) Widdrington accepts Castor Directorship

64. After October 1988, Widdrington continued meeting with and contacting Stolzenberg and others from Castor.[93]

65. At a lunch in Toronto on Wednesday, December 13, 1989, Stolzenberg invited Widdrington to become a director of Castor. To do so, a minimum investment of $1 million was required.[94] With this invitation Stolzenberg provided:

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89 §3198.
90 PW-34.
91 §3203.
92 §3202.
93 §3204.

a) a 3-page letter dated December 12, 1989 from Stolzenberg inviting him to invest in units consisting of a mixture of Castor shares and debentures, enclosing: 1) Castor's Unaudited Interim Statements as at September 30, 1989; 2) Castor's Five Year Forecast; and 3) C&L Valuation Letter dated October 17, 1989;[95]

b) Castor's audited consolidated financial statements for the year ended December 31, 1988;[96]

c) portions of Castor's consolidated financial statements for the five years ended December 31, 1988 without any note disclosure or auditor's reports;[97] and

d) a list of Castor's senior management and board members.[98]

66. The package did not include a Legal-for-Life opinion nor a Legal-for-Life Certificate.[99]

67. On Thursday December 14, 1989, upon returning to his office in London, Ontario, Widdrington "glanced" at the package and gave it to Prikopa for his advice.[100]

68. Prikopa reviewed the Stolzenberg package, gave it to Wood,[101] met with Widdrington[102] and prepared a memo which he gave to Wood.[103] The next day, Friday December 15, Prikopa and Wood called Stolzenberg for more information.[104] Stolzenberg promised more materials (Shareholders' agreement and a loan portfolio

94 §§3205, 3207.
95 PW-10.
96 PW-10-1.
97 PW-10-2.
98 PW-10-3, §§3205-06.
99 §3206.
100 §3208; Widdrington, Dec. 16, 2004, pp. 41, 44-48.
101 §3209; Prikopa, Jan. 12, 2005, pp. 45-48.
102 §3210; Widdrington, Nov. 30, 2004, pp.10-11.
103 Prikopa, Jan. 12, 2005, pp. 94-95.
104 §3215; Prikopa, Jan. 12, 2005, pp. 97-99.

analysis).[105] Following this call, Prikopa finalized his memo to Widdrington[106] outlining various risks, concerns and questions:

> *"1. A $1 million investment is of substantial size relative to your portfolio and will be totally locked in – no provision for exit – money will be totally at risk of business – pay back only from long run earnings.*
>
> *2. Business is doing very well but greatly sensitive to financial market conditions – i.e. interest rates, exchange, etc., and particularly ability to continue to make strong spreads of 3% between loans placed and cost of borrowed money. Major risk is always spreads and quality of loans made, i.e. risk of loan loss.*
>
> *3. What is the quality of present loan assets? How good are they – are there any shaky loans in portfolio?*
>
> *4. Much of money invested in mortgages, etc., matures in 1990 and 1991 (close to 85%) – will company be able to redeploy these monies (about $1.1 billion) back into market with the same good 3% spreads?*
>
> *5. How well do you know the management and how the company conducts its business – the material or Financial Statements don't tell about that: -*
>
> *- Where is most of money employed – America, I guess? –*
>
> *- Where is most of borrowed money sourced from – from Europe maybe?*
>
> *- What is the average quality of loans made – I assume they operate in the higher rate higher risk loan market – the 13% average rate earned and 3% spread suggests higher loan risk. –*
>
> *- How does company deal with exchange factor in business? Is it hedged at a risk or used as a bet to take money on it? –*
>
> *- What are company's long run plans on leverage?*
>
> *- Will it be maintained at present level? –*
>
> *- How well does management and board work together –*

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105 Prikopa, Jan. 12, 2005, pp. 98-99.
106 Prikopa, Jan. 12, 2005, p. 100; PW-43-1.

- Is it a close knit group network?

- Is much of the business generated through this network? –

- What is the level of integrity brought to business deals?

6. Do you trust management and have total confidence that this group will run a successful business for years to come? At present cash return, you will need to count on at least 5 to 10 years of business success to get your money back."[107] [emphasis added]

69. On Monday, December 18, after speaking with Taylor, Prikopa prepared a handwritten analysis[108] concluding that, on a cash-flow basis, it would be more advantageous to invest in three (3) units not four (4) but added: *"as long as it still gets the board position"*.[109]

70. The same day, after speaking again with Prikopa, Wood and Taylor, Widdrington, without waiting for the further information promised by Stolzenberg on Castor's loan portfolio and shareholders agreement, had Prikopa inform Castor of his decision to buy 4 units.[110]

71. Widdrington's investment consisted of four units containing convertible debentures, preferred shares and common shares of Castor, for which he applied his $200,000 original investment and capitalized interest[111] and paid the difference.[112]

72. Widdrington's receipt of information, meetings, reviews and decisions occurred in Ontario.[113]

73. After Widdrington's decision to invest was made and communicated to Castor, Prikopa received the Restated Shareholder Agreement,[114] and information on Castor's

[107] §3218; PW-43-1,
[108] PW-43-2.
[109] §§3219-20; Prikopa, Jan. 12, 2005, p. 135.
[110] Prikopa, Jan. 12, 2005, pp. 138-39; PW 43-3, PW-43-4.
[111] §3226; PW-10; PW-11-2.
[112] PW-43-2; Widdrington, Dec. 17, 2004, pp. 83-87.
[113] PW-35; PW-36-4; PW-10; PW-17; PW-11-5.

mortgage portfolio, entitled "Mortgage portfolio analysis – December 31, 1988".[115] The Plaintiff's expert Paul Lowenstein ("Lowenstein") opined this did not provide an adequate response to Prikopa's concerns.[116]

6) Widdrington – a Passive Director

74. Widdrington was a director of Castor from March 21, 1990[117] until the end in 1992.

75. During his tenure, Widdrington attended several board meetings and two (2) shareholders' meetings, in respect of which he received numerous memos from Prikopa prior to the meetings urging him to obtain more information about the business and affairs of Castor.[118]

76. Prikopa confirmed Widdrington's failure to follow-up, lack of interest in obtaining answers to these questions and passivity:

   a) he confirmed that Widdrington never got back to him to confirm that he had obtained the requested information;[119]

   b) while Widdrington agreed that some of the missing information went to the heart of the business, he did nothing to obtain it directly from the board;[120]

   c) he told Widdrington "...*that what we had looked for from board materials was really not coming through*";[121] and

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114 Prikopa, Jan. 12, 2005, p. 140; PW-43-5.
115 PW-10-5.
116 Lowenstein, March 24, 2005, pp. 58-60.
117 See the minutes included in the Directors' Book, PW-12.
118 The memos include not only the initial memo of Dec. 18, 1989, PW-43-1, but also those filed as PW-44-1, PW-45, PW-46 and PW-47; See Castor's Directors' Books and minutes, PW-12, PW-12-1, PW-13, PW-13-1, PW-14, PW-14-1, PW-15, PW-16-1, PW-16-2, PW-16-3, PW-18, PW-51, PW-52, PW-53 and PW-2384-1.
119 Prikopa, Dec. 4, 1997, p. 79.
120 Prikopa, Dec. 4, 1997, p. 149.

d) he advised Widdrington that "*The financial risk of your investment in Castor is hard to gauge because Castor does not provide disclosure on the status of its business and risks in its loans.*"[122]

77. Widdrington's deposition also confirms that he did nothing to understand and monitor the business and affairs of Castor:

a) he stated: "*Let me repeat, I came on the board with the understanding that I knew very little about the company or the business.*";[123]

b) he did not, at any time, raise any issue with the board about the business and affairs of Castor;[124]

c) he stated he never inquired into particular loans or particular borrowers of Castor;[125]

d) he did not recall specific discussions on related parties;[126]

e) he did not recall any specific discussions or review of the annual financial statements;[127]

f) he did not reveal that he was a director of Trinity to his fellow Castor directors other than Stolzenberg;[128]

g) he did not recall that any director raised the issue of the identity of Castor's borrowers;[129]

121 Prikopa, Dec. 4, 1997, p. 166.
122 See Prikopa's memo of Oct. 6, 1991, PW-47, and Dec. 4, 1997, pp. 198-201.
123 Widdrington, Nov. 9, 1995, p. 41.
124 Widdrington, Nov. 9, 1995, p. 47.
125 Widdrington, Nov. 9, 1995, p. 49.
126 Widdrington, Nov. 9, 1995, p. 50.
127 Widdrington, Nov. 9, 1995, pp. 50-51.
128 Widdrington, Dec. 15, 2004, pp. 53-54.

h) he did not recall any discussion on capitalization of interest;[130] and,

i) he did not recall doing anything else to try to understand the business and affairs of Castor.[131]

78. Michael Dennis ("Dennis"), a director and Corporate Secretary of Castor at the time, confirmed that Stolzenberg had full authority and that the board did not discuss individual loans.[132]

7) Widdrington surprised by Castor's Liquidity Crisis

79. In September 1991, Widdrington was paid his Castor dividend of $61,120. Shortly thereafter, by letter to the directors dated September 25, 1991,[133] Stolzenberg requested an increase in the capital base of Castor of $25 million. The letter mentioned the tightening of credit lines for real estate activities and was accompanied by Castor's unaudited financial statements as at June 30, 1991. Widdrington indicated that this capital call had never been discussed and came as a surprise.[134]

80. At Widdrington's request, Prikopa prepared another analysis dated October 6, 1991 using Castor's unaudited June 30, 1991 financial statements.[135] Prikopa's memo[136] raised concerns as to the advisability of investing in another unit of Castor:

> *At page 1: "Is this a good investment? Yes, provided you can assure yourself at the Board meeting that Castor's loan portfolio does not have undue risk, and that all other investors are also committed to the added capital" [...]*

129 Widdrington, Nov. 9, 1995, p. 55.
130 Widdrington, Nov. 9, 1995, p. 65.
131 Widdrington, Nov. 9, 1995, p. 69.
132 Dennis, Sept. 8, 1995, pp. 38-39; PW-2400 series.
133 PW-17.
134 Widdrington, Nov. 9, 1995, p. 152.
135 Prikopa, Dec. 4, 1997, pp. 181-95.
136 PW-47.

At page 2: "*Peter, However you need to feel comfortable with the risks:*

- *The added $292,000 will raise your total stake in Castor to $1.4 million – close to 20% of your financial assets net worth.*

Normally, it is not prudent to commit that much of a portfolio to a single investment, unless you have some control.

- *The financial risk of your investment in Castor is hard to gauge because Castor does not provide disclosure on the status of its business and risks in its loans.*

- *Your investment in Castor is not easy to cash out if for some reason you wanted to get out.*

Cash out is possible but is at the discretion of Castor, and if Castor got into trouble a sell would not be possible.

Peter, all I am saying is that you need to feel comfortable with these concerns before you put more money into Castor. The Castor investment is becoming your single largest dollars holding (since you are slowly divesting your Labatt stock) – does this fit with your plans, and are you planning to stay on the Castor Board for some time."[137]

81. Widdrington delayed his decision on this investment until after the Castor board meeting in New York City on October 24, 1991.[138] The Board information package included C&L's October 1991 Valuation Letter based on Castor's September 30, 1991 unaudited financial statements.[139] At that meeting:

> "*The Chairman reported that as a result of the current environment in the banking industry Castor had recently experienced a reduction or cancellation of certain of its credit facilities (particularly with the Japanese and French banks) which, together with the necessity for the Corporation to refinance certain of its mortgage loans (where other financing was not available to borrowers), was causing a liquidity problem for Castor, which the Chairman was working hard to solve. He stated that certain shareholders were prepared to reinvest their dividends to alleviate this problem. The directors unanimously*

137 For Prikopa's deposition with respect to this memo PW-47, see Dec. 4, 1997, pp. 181-95 incl.

138 Widdrington, Dec. 1, 2004, pp. 163-64. The Directors' Book of this board meeting was filed as PW-18 and the minutes thereof as PW-51.

139 PW-6-1.

> *endorsed the Chairman's efforts to correct the situation, and the meeting agreed that it was in the best interests of the Corporation to raise additional capital and to secure medium term debt financing. The Chairman pointed out that the minimum target for raising funds should be $50,000,000 but ideally $100,000,000 to overcome the present situation and to look positively forward towards 1992. The Chairman also stated that further support of the present shareholders would be absolutely necessary. In that connection the Chairman reported that he had already secured additional capital subscriptions from existing shareholders for $1.5 million."*[140]

82. Widdrington described the somber atmosphere at this board meeting:

> *"Q. How would you describe the atmosphere of that Board meeting?*
>
> *A. It was considerably more sombre than previous meetings.*
>
> *Q. Sombre in the sense that...*
>
> *A. serious.*
>
> *Q. Is that because of the – what would you ascribe this somberness to at this October twenty-fourth (24th) meeting?*
>
> *A. Well, my guess is that it might have been the fact that the directors had been asked to put up more money.*
>
> *Q. That wasn't the first time they were asked to do so, was it?*
>
> *A. It was as far as I was concerned.*
>
> *Q. Did you know at the time whether they had been previously asked to increase their shareholding?*
>
> *A. I did not.*
>
> *Q. Was the somberness also due to the state of the real estate market, in your view?*
>
> *A. I'm not going to attempt to explain the fact that I felt the meeting was somber, outside of my own reaction.*
>
> *Q. Was it your reaction that the request for increasing the shareholdings was a sign of problems for the company?*

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140 PW-51.

A. It was a sign of some sort of problem in the sense that a system that previously existed wasn't functioning quite as well as it has in the past."[141]

8) Widdrington "Taking One for the Team"

83. On October 25, 1991, after he returned to Toronto from the Board Meeting, Widdrington decided to buy one (1) further Castor unit (composed of debentures, preferred shares and common shares) for a total of $292,560.[142]

84. Widdrington acknowledged that in putting money into Castor on October 25, 1991:

a) he was "taking one for the team"[143] which he explained as "making a sacrifice";[144]

b) he did not have the information on the concerns raised by Prikopa in his memo of October 6, 1991;[145]

c) "*...I felt this investment was sort a riskier tail-end than the original one had been. I would be less than honest if I indicated that it was not.*";[146]

d) there was "*...more risk at this point in time but there was a risk to, in my mind that if the directors and other shareholders didn't come up with more money, the whole thing could disappear,...*".[147]

9) Widdrington Finally Inquires

85. At the board meetings in Zurich on February 13, 1992[148] and in Montreal on February 16, 1992,[149] Stolzenberg informed the directors that, even though Castor had

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141 Widdrington, Nov. 9, 1995, pp. 163-64, Q. 734-740.
142 §3237.
143 Widdrington, Nov. 9, 1995, pp. 177-78, Q. 806.
144 Widdrington, Dec. 2, 2004, pp. 53-56.
145 Widdrington, Jan. 6, 2005, pp. 161-65; PW-47.
146 Widdrington, Nov. 9, 1995, pp. 159-60.
147 Widdrington, Nov. 9, 1995, pp. 159-60.

paid all its debts up to this point, it was insolvent. These are the first minutes indicating that the directors asked for specific financial information similar to that sought by Prikopa in his memos.[150]

86. After these meetings, Widdrington finally sought information from Stolzenberg about Castor's business.[151]

10) Widdrington sued as Defaulting Director

87. After Castor's bankruptcy in July 1992, Castor's Trustee sued Castor's directors, including Widdrington, for:

a) illegally declaring dividends in 1991;[152] and

b) breach of duty for failing to adequately monitor Castor's business.[153]

88. Shortly after the Widdrington claim against C&L was chosen to be the first one tried, the Trustee settled with Widdrington and took control of his claim. The settlement was for $600,000 and an interest in the first $650,000 from any damage award to Widdrington in the present action.[154]

89. Widdrington testified that he settled for personal reasons and to avoid the additional exposure that he faced.[155]

90. On July 30, 2008, the Honourable Justice Louise Lemelin rendered judgment on the Trustee's petition seeking reimbursement of dividends. This judgment acknowledged the settlement arrived at between the Trustee and several directors, including

148 PW-52.
149 PW-53, PW-2384-1.
150 See the minutes PW-2384-1 and Widdrington, Jan. 7, 2005, pp. 78-80.
151 Widdrington, Nov. 10, 1995, p. 7, Dec. 3, 2004, pp. 35-36; PW-55-1, PW-55-2.
152 PW-1.
153 PW-8-A.
154 PW-39.
155 Widdrington, May 22, 1998, pp. 16-17, Dec. 3, 2004, pp. 125-28; PW-39-1.

Widdrington, and condemned the others, including Dr. Marco Gambazzi ("Gambazzi"), to pay to the Trustee an amount of $8,759,490 with interest thereon and a special indemnity.[156] In the judgment, Justice Lemelin noted that Castor's directors had failed to discharge their duties.[157]

F) WIDDRINGTON'S DAMAGES CLAIM

91. Widdrington's damages totalling $2,672,960 are broken down as follows:

- $1,422,960 representing the full refund of his total investments in Castor made in December 1989 and October 1991; and

- $1,250,000 representing the amounts paid or to be paid to the Trustee under his settlement.

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156 *RSM Richter inc.* v. *Gambazzi*, 2008 QCCS 3437, at para. 146.
157 *RSM Richter inc.* v. *Gambazzi*, 2008 QCCS 3437, at paras 80 and 83.

PART II – QUESTIONS IN DISPUTE

The issues in dispute are as follows:

A – WITH RESPECT TO THE RULES GOVERNING AUDITORS' LIABILITY:

1) **What law governs Plaintiff's claim: Quebec civil law or the common law principles regarding negligent misrepresentation?**

Defendants submit that the trial judge erred in applying Quebec law rather than the principles of Canadian common law. Irrespective of whether the law applicable to the liability of a corporation's auditor is the law where the alleged delict occurred (*lex loci delicti*) or the law of the corporation (*lex societatis*), the applicable law in the present case is either Ontario or New Brunswick law, with the consequence that Canadian common law applies.

2) **If the Canadian common law principles apply, are the usual concerns regarding indeterminate liability present, as in most auditors' cases?**

Defendants submit that, contrary to what the trial judge found, under the principles laid down by the Supreme Court in *Hercules*, C&L did not owe any duty of care to the Plaintiff, as neither of the two required conditions to alleviate the risk of indeterminate liability are met on the facts of the case, and therefore the usual concerns apply.

3) **Subsidiarily, if Quebec civil law applies, is an auditor liable to a third party, if such third party was not the intended recipient of the auditor's representation or did not use it for the specific purpose for which it was prepared?**

Defendants submit that the trial judge erred in law when she concluded that under Quebec civil law, an auditor issuing an opinion is liable "to the whole world". This reasoning is incompatible with the principles enunciated by the Supreme Court in the *Houle* and *Bail* cases, and by this Court in the *Savard* decision.

B – WITH RESPECT TO CAUSALITY AND DAMAGES:

1) **Did Widdrington discharge his duties as a director of Castor? If not, is he allowed in law to shift to the Defendants the costs of the settlement he reached with the Trustee with respect to his defaults as a director of Castor?**

Defendants submit that the trial judge erred in law in assessing Widdrington's conduct as a director according to a subjective test that has been rejected by the Supreme Court of Canada in *Wise.* Under the appropriate objective test, it is manifest that Widdrington totally failed to discharge his duties as director of Castor.

As a consequence, and as a matter of law, Widdrington (who, as a director, was primarily entrusted with the task of establishing Castor's financial statements) cannot claim from the auditor the amounts he paid or will pay to the Trustee in relation with his own negligence to adequately monitor Castor's affairs or know about its financial situation.

2) **Did Widdrington, a sophisticated investor and director, establish that he relied, in a reasonable manner, on C&L's impugned Representations for his investments in Castor?**

Defendants submit that the trial judge erred in concluding that the Plaintiff had relied, in a reasonable manner, on the impugned C&L Representations.

With respect to the October 25 ,1991 investment, the C&L Representations on which he allegedly relied had clearly been superseded by the information provided at the October 24, 1991 Board meeting, thus making any reliance on them, without further inquiry as required by law, unreasonable. Moreover, Widdrington admitted that this further investment was "a sacrifice he was taking for the team".

With respect to the December 1989 investment, Widdrington invested in Castor without first obtaining information not revealed by the audited financial statements or the Valuation Letter that his advisors urged him to obtain before investing. As a consequence, he cannot be said to have relied in a reasonable manner on the said audited financial statements or Valuation Letter.

3) **Subsidiarily, did the trial judge err in the calculation of the damages?**

Defendants submit that the trial judge erred in the calculation of the damages, in that she:

- failed to deduct from the calculation of Plaintiff's damages the benefits Widdrington derived from his investments in Castor;

- condemned the Defendants to pay interest and the additional indemnity from the date of service of the action on amounts that had not yet been paid at that date, or not paid at the time of judgment.

C – WITH RESPECT TO NEGLIGENCE:

4) **Did the trial judge err in determining that the financial statements for 1988-1990 did not fairly present Castor's financial situation in accordance with GAAP and in determining that the Valuation Letters and the Legal-for-Life Certificates were negligently prepared?**

Defendants submit that the trial judge erred for the following reasons:

- she relied on illegal evidence by: a) allowing the introduction of 6 new expert reports after the beginning of the trial in circumstances where this was highly prejudicial; and b) by adopting a 'Read-in-Rule' according to which the content of the report was considered to be evidence before the court;

- she applied incorrect standards when judging the financial statements, the Valuation Letters and the Legal-for-Life Certificates, notably by: i) applying hindsight; ii) misconstruing Castor's contracts and relevant statutory provisions;

iii) selecting between two professional schools of thought; iv) failing to apply the professional standards identified by Plaintiffs' own experts; and v) applying standards that were not required at the relevant time;

- she completely ignored substantial parts of the evidence and manifestly erred in assessing the credibility of Plaintiff's experts.

5) **Did the trial judge err in determining that the 1988-1990 audits were not conducted according to GAAS in relation to the specific misstatements that were found, and whether a properly conducted audit would have discovered the misstatements?**

Defendants submit that the trial judge erred in respect of the foregoing by, *inter alia*, using hindsight; failing to identify and apply the appropriate standards; failing to apply the standards as explained by the experts whose opinions she adopted and by failing to properly connect the GAAP misstatements to specific GAAS procedures.

D – WITH RESPECT TO THE LIABILITY OF INDIVIDUAL PARTNERS:

Is the individual liability of C&L's partners in equal shares or solidary?

The trial judge erred in law when she concluded that the individual partners' liability for a debt of the partnership was solidary rather than limited to equal shares, under art. 1854 CCLC, and as established by the Supreme Court in *Pérodeau* v. *Hamill.*[158]

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158 [1925] S.C.R. 259.

E – WITH RESPECT TO COSTS:

Did the trial judge err in condemning the Defendants to all costs of both trials, including those related to the common issues?

Defendants submit that the trial judge erred in condemning them to all the costs of both trials, including on the common issues, notably as this totally fails to take into account the fact that the other Castor plaintiffs' files have been suspended and it is unknown at this stage whether they will succeed against the Defendants. The only practicable approach in the circumstances is to proceed on a *pro rata* basis. In addition, Defendants submit that the trial judge failed to properly exercise her discretion on costs, as required by articles 466 and 477 C.C.P.

PART III – ARGUMENT

SECTION I - RULES GOVERNING AUDITORS' LIABILITY

A) THE ERRONEOUS APPLICATION OF QUEBEC LAW (CONFLICT OF LAW ISSUE)[159]

92. The trial judge concluded that Quebec law applied. She considered that the *lex loci delicti* rule was applicable, and further considered that the alleged delict had occurred in Quebec as she found that the "reproached acts" (i.e. the alleged fault) occurred in Montreal where the impugned C&L representations were issued (§§3370-86).[160]

93. This conclusion is the result of numerous errors of law:

   a) a proper application of the *lex loci delicti* rule leads to the application of Ontario law: as indicated by the Supreme Court of Canada in *Tolofson*, it is not the place of the fault that determines where a delict occurs but rather the place of prejudice;

   b) the delictual liability of a corporation's officer for a faulty performance of his duties is not governed by the *lex loci delicti* rule, but rather by the law which creates and defines his office and duties, i.e. the law applicable to the corporation itself (*lex societatis*). In the present case, this would lead to the application of New Brunswick law.[161]

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159 As noted by the trial judge (§3347), the parties agree that the CCLC applies to this issue as the relevant events took place before January 1st, 1994.

160 In light of her conclusions, the trial judge considered that the application of Quebec law was a "common issue" and thus that it applies to all Castor cases, including Widdrington. This is an error. The only "common issue" in that respect is the determination of the relevant rule of conflict and connecting factor.

161 Issues of capacity and status of a person are governed by the law of that person's domicile (cf. 6(3) CCLC). A legal person is deemed to be domiciled in the jurisdiction under the laws of which it has been constituted, irrespective of where its legal or *de facto* head office is situated: J. Talpis, *Aspects juridiques de l'activité des sociétés et corporations étrangères au Québec*, (1976) C.P. du N. 215, paras 10-11. See also : *Belmoral Mines Ltd.* v. *Royal Trust Company*, [1985] R.D.J. 597 (C.A.) and G. Goldstein & E. Groffier, *Droit international privé*, t. 2, *Règles spécifiques*, Cowansville, Yvon Blais, 2003, pp. 53-56; C. Emanuelli, *Droit international privé*

94. Therefore, irrespective of which rule of conflict is applied, Plaintiff's claim is to be assessed by Canadian common law principles, and not by Quebec civil law. This is of crucial importance as the Supreme Court of Canada has established in *Hercules* that, in principle, auditors are not liable to investors.

1) If the *lex loci delicti* is applicable, the alleged delict would have occurred in Ontario

95. In *Tolofson*, the Supreme Court of Canada discarded the traditional common law rule of conflict (which essentially led to the application of the law of the forum and, hence, to forum shopping) in favour of the *lex loci delicti.*[162] In Quebec, this meant the rehabilitation of the *lex loci delicti* rule, which had always been considered the applicable rule of conflict for delictual liability under the CCLC until the Supreme Court imposed the traditional common law rule in 1930.[163]

96. The trial judge stated that "*the lex loci delicti rule means the place where the alleged wrongdoings (reproached acts) took place, the place where the wrongful activity occurred*" (§3382). She further stated that "*the wrongdoings (reproached acts): the negligent issuance of audit reports, consolidated audited financial statements, valuation letters and Certificates for Legal-for-Life Opinions took place in Montreal*" (§3385).

97. This reasoning is in complete contradiction with the relevant principles of private international law, as notably enunciated by the Supreme Court of Canada in *Tolofson*, with respect to the *situs* of a delict for the application of the *lex loci delicti* rule.

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québécois, 2^e ed., Montréal, Wilson & Lafleur, 2006, para. 510; W.J. Johnson, *Conflict of Laws*, 2nd ed., Montreal, Wilson & Lafleur, 1962, p. 103:

162 *Tolofson*, p. 1053.

163 *O'Connor* v. *Wray*, [1930] S.C.R. 231; *McLean* v. *Pettigrew*, [1945] S.C.R. 62; cf. J.G. Castel, *Droit international privé québécois*, Toronto, Butterworths, 1980, pp. 447-51; P.A. Crépeau, *De la responsabilité civile extracontractuelle en droit international privé québécois*, (1961) 39 Can. B. Rev. 3.

98. In *Tolofson*, the Supreme Court of Canada indicated that where a fault committed in one jurisdiction causes a prejudice in another, the delict is to be situated at the place where the prejudice occurs:

> *"There are situations, of course, notably where an act occurs in one place, but the consequences are directly felt elsewhere, when the issue of where the tort takes place itself raises thorny issues. In such a case, it may well be that the consequences would be held to constitute the wrong."*[164] [emphasis added]

99. This stems from the fact that a fault, in itself, does not give rise to a delict: a delict only occurs when (and hence where) the fault causes a prejudice. In *Moran v. Pyle National (Canada) Ltd.*,[165] Dickson J., writing for the Supreme Court, stated :

> *"For myself, I have great difficulty in believing that a careless act of manufacture is anything more than a careless act of manufacture. A plaintiff does not sue because somebody has manufactured something carelessly. He sues because he has been hurt. The duty owed is a duty not to injure."* (p. 404)[166] [emphasis added]

100. According to the Supreme Court, this demonstrates that the prejudice rather than the fault is the "predominating element" of civil liability.[167]

101. There are many additional reasons to prefer the place of the prejudice to situate a delict.[168] First, this is more in line with the indemnification (rather than punitive) role of contemporary delictual liability :

> *"Dans la mesure où l'ordre public est troublé par un délit ou quasi-délit, c'est au lieu de réalisation du préjudice que l'atteinte se*

164 *Tolofson*, p. 1050.
165 [1975] 1 S.C.R. 393.
166 *Ibid.*, p. 404; see also *Bourque* v. *Proctor and Gamble inc.*, [1982] R.P. 52 (C.S.), pp. 54-55.
167 *Moran*, p. 409.
168 Cf. A. Weill, "*Un cas épineux de compétence législative en matière de responsabilité délictuelle , la dissociation de l'acte générateur de responsabilité et du lieu du préjudice*", Mélanges Jacques Maury, Paris, Dalloz, 1960, 545.

> *produit; c'est en ce lieu que se situent les intérêts que le Droit se doit de protéger."*[169]

Second, this often leads to the application of the law of the plaintiff rather than the law of the defendant, which solution is again more in line with the protection of the victim's legal interests: the victim will succeed or fail according to his own law rather than according to the law of the wrongdoer.[170] Third, the application of the law of the fault leads to inextricable difficulties in the case of contributory faults committed in various jurisdictions:

> *"...[il] est sans inconvénient d'appliquer distributivement plusieurs lois aux divers préjudices résultant d'un même acte, alors qu'il est impossible d'appliquer plusieurs lois à la réparation d'un préjudice unique. C'est d'ailleurs le signe que le préjudice est plus au cœur de la responsabilité que la faute."*[171]

102. It is therefore not surprising that the law of the prejudice is favoured by the doctrine[172] and that it has recently been adopted (with some minor variations) by legislators in Switzerland,[173] U.K.[174] and Europe.[175] It has also been adopted by the Quebec legislature: according to art. 3126 of the C.C.Q., when a fault committed in one jurisdiction causes a prejudice in another, the delict is governed by the law of where

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169 *Ibid*, p. 552.

170 *Ibid*, p. 556.

171 Mayer & Heuzé, *Droit international privé*, 8th ed., Paris, Montchrestien, 2004, p. 505; see also: H. Batiffol and Lagarde, *Droit international privé*, 7th ed., t. 2, Paris, LG.D.J., 1983, para. 561.

172 Weill, *supra* note 168; Battifol & Lagarde, *supra* note 171; G. Légier, "*Sources extra-contractuelles des obligations: Détermination de la loi applicable*", *Juris-Classeur de droit international*, Fasc. 553-1, 1993, para. 99; P. Mayer & V. Heuzé, *supra* note 171, pp. 500-07; Y. Loussouarn, P. Bourel et P. de Vareilles-Sommières, *Droit international privé*, 8th ed., Paris, Dalloz, 2004, pp. 533-39; J.G. Castel, *Droit international privé québécois*, Toronto, Butterworths, 1980, p. 467; P.A. Crépeau, "*De la responsabilité civile extracontractuelle en droit international privé québécois*" (1961) 39 Can. B.R. 3, p. 16 (note 39); J. Walker, *Canadian Conflicts of Laws*, 6th ed., vol. 2, Butterworths, 2005, pp. 35-1 to 35-6, 35-17 to 35-21; D. Lasok & P.A. Stone; *Conflict of Laws in the European Community*, Milton, England, 1987, p. 394.

173 s. 133 of *Loi fédérale sur le droit international privé de 1987*.

174 s. 11, *Private International* Law (Miscellaneous Provisions) *Act*, 1995 U.K. c. 42.

175 Art. 4, *Regulation of the European Parliament and Council on the law applicable to Non-Contractual Obligations* (EC no. 864/2007).

the prejudice occurs (except when the wrongdoer could not reasonably have foreseen that his act could have an impact elsewhere).[176]

103. As is apparent from §3382, the trial judge confused the "wrongful activity" referred to in *Tolofson* with the "fault". The "wrongful activity" is not the "fault" but rather the "delict" and the delict does not occur until the prejudice itself occurs.[177]

104. In *Leonard v. Houle*,[178] the Ontario Court of Appeal, relying on *Tolofson*, concluded that the relevant "connecting factor" for the application of the *lex loci delicti* is not the place where the fault is committed but rather where the prejudice occurs. This case dealt with a car chase commenced (allegedly in a negligent manner) in Ontario by the Ottawa police which resulted in a serious car accident in Quebec. The issue of what law applied was crucial since the Quebec "no-fault" legislation barred the claim. The plaintiffs had introduced a claim before the Ontario courts against the Ottawa police and argued that Ontario law applied as this was where the "wrongful activity" (the negligent commencement of the car chase) had occurred. This argument was rejected. Charron J.A. (as she then was) stated for the Court:

> ***"It seems clear to me that the wrong occurred in the province of Quebec because the injury occurred there****. The Plaintiffs are not suing because the Ottawa police breached their duty when they commenced a chase while they were in the province of Ontario (...). They are suing because Leonard was injured in the resulting car accident in the province of Quebec.* ***The activity which took place in the province of Ontario, even if found to constitute a breach of duty on the part of the Ottawa police, does not mount to an actionable wrong. The place where the "activity took place" which gives rise to the action is in the province of Quebec."*** (pp. 646-47) [emphasis added]

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176 J. Talpis & J.G. Castel, "Interprétation de règles du droit international privé", in *La réforme du Code civil*, tome II, 1993, P.U.L., no. 365.

177 *Supra*, para. 99; see also *A. Côté et Fères Ltée* v. *Laboratoires Sagi inc.*, [1984] C.S. 255: "*[Q]uel que soit l'endroit où un [...] produit est fabriqué, le* locus delicti *est l'endroit où le dommage est effectivement causé.*" (p. 259).

178 (1997) 154 D.L.R. (4th) 640.

105. In her analysis, the trial judge failed to take into account, or even mention, not only the statement of the Supreme Court in *Tolofson* referred to above, but also all the authorities that have applied it.[179] Her reasoning, which gives precedence to the element of fault to situate the delict, runs contrary to all the above-mentioned authorities. Indeed, the authorities referred to by the trial judge at §3382 do not support her conclusion. The trial judge relied on:[180]

1. ***Tolofson***, which as explained above stands for the application of the law of the prejudice;

2. **Castel & Walker**, supra note 172, who indicate in the page referred to that the Supreme Court in *Tolofson* is inclined to apply the law of the prejudice;

3. **P.A. Crépeau**, *supra* note 172, who states in the article referred to that, for the purposes of the *lex loci delict: "on doit, nous semble-t-il, préférer la loi du préjudice*" (note 39);

4. ***Lister v. McAnulty***, [1944] S.C.R. 317, where the Supreme Court applied Quebec law because the "*damages* [had] *occurred in Quebec*" (p. 326) [emphasis added];

5. **E. Groffier** (*Droit international privé québécois*, 4th ed., 1990, p. 217), whose analysis predates *Tolofson* and who indicates that the application of the law of the fault can be criticized when the prejudice occurs elsewhere, and

6. **J. Pineau & M. Ouellette** (*Théorie de la responsabilité civile* Thémis, 1980) whose book on Quebec delictual liability simply does not address the issue of where to situate a delict for conflict of laws purposes.

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179 In addition to the *Leonard* case, see: *Ostroki* v. *Global Upholstery*, (1995) O.J. no. 4211 (Ontario S.C.); *Ross* v. *Ford Motor Co. of Canada*, (1997) N.W.T. no. 30 (N.W.T.S.C.); *Barclay's Bank PCL* v. *Inc. Incorporated*, (1999) ABQB 110, para. 42; *Shane* v. *JCB Belgium N.V.* (2003) O.J. 4497 (Ont. S.C.).

180 Cf. footnotes 3655 and 3656 of the Judgment.

106. The trial judge's conclusion that *lex loci delicti* means the place where the "reproached act" (i.e. the fault) occurred is thus totally unsupported, contrary to leading authorities, and is a manifest error of law. If the *lex loci delicti* rule applies, then the alleged delict occurred where Widdrington suffered his prejudice.

107. Since the prejudice at issue is of a purely financial nature, it must be situated at the place where Widdrington's patrimony was situated, hence at the place of his domicile, in London, Ontario. In *Banque de Montréal* v. *Hydro Aluminium Wells inc.*,[181] this Court indicated that a purely financial prejudice is necessarily situated at the plaintiff's domicile.[182] This view is shared by leading authors.[183] As a consequence, if the *lex loci delicti* rule is applicable, the law of Ontario applies.

108. Even if we were to assume that the relevant factor is the place of the fault, as decided by the trial judge, the alleged delict would nevertheless be situated in Ontario where the impugned C&L Representations were received by Widdrington.[184]

109. The case law clearly establishes that, where incomplete or misleading information is provided to the plaintiff by the defendant, the <u>fault</u> is not committed at the place where the information is prepared or issued by the defendant, but rather where the information is received by the plaintiff.

110. In *Air Canada* v. *McDonnell Douglas Corp.*, the Supreme Court established that the *locus* of the fault, when a defendant has failed to adequately warn the plaintiff of a potential danger, was the place where "*the warning ought to have been <u>received</u>*".[185] Applying this principle to the transmission of incomplete or misleading information, this

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181 March 2, 2004 (AZ-50225218).

182 *Ibid*, para. 30.

183 G. Légier, *Sources extracontractuelles des obligations: Détermination de la loi applicable*, *Juris-classeur de droit international*, Fasc. 553-1, 1993, para. 118; Alex Weill, *supra*, p. 555; D. Lasok and P.A. Stone, *supra* note 172, pp. 394-5.

184 §§3205 and 3240.

185 [1989] 1 S.C.R. 1554, p. 1569.

Court has determined that the place of the fault occurs where the plaintiff receives the erroneous information.[186]

2) ***Lex societatis*** **applies**

111. The trial judge rejected the application of the *lex societatis* on the basis that the liability of a corporation's auditor is not a matter governed by the law applicable to the corporation (§3375). This conclusion is an error of law. According to the authorities, the auditor is an integral part of the corporation's structure and a corporate officer, thus leading to the application of the law of the corporation to govern his liability.

112. Both in Quebec and France, leading authorities consider that the delictual liability of a corporation's officer for a fault committed in the performance of his duties is to be governed, not by the *lex loci delicti*, but rather by the law applicable to the corporation itself. Thus Pr. Talpis and Castel are of the view that:

> *"La loi applicable à la société détermine ses conditions de constitution, sa capacité de jouissance, ses conditions de*

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186 *Trans-Dominion Energy Corp.* v. *Total Return Fund inc.*, [1990] R.D.J. 479 (C.A.); *ABN Amro Bank Canada* v. *Hayward & Company Ltd.*, J.E. 99-1136 (C.A.). See also *Newage (Canada) Ltd.* v. *Canadian Pacific Railway Co.*, [1960] B.R. 956; *Yufe* v. *Tapping*, [1986] R.J.Q. 1245 (C.S.), p. 1248: "*Le manquement à l'obligation d'information vraie et non trompeuse se fait à l'endroit où l'on informe l'acheteur, et non où l'on rassemble l'information*"; *Royal Bank of Canada* v. *Capital Factors inc.*, J.E. 2004-1644 (C.S.), p. 7, conf. par J.E. 2004-2164 (C.A.). In the common law jurisdictions, it is recognized that the tort of misrepresentation is committed at the place where the representation is received and acted on, and not at the place from which it was sent: *Original Blouse Co. Ltd.* c. *Bruck Mills Ltd.* (1963), 42 D.L.R. (2d) 174, (B.C.S.C.), pp. 6-7: *"It seems to me patent that a false statement of fact is not to be considered a misrepresentation until communicated by the representor to the representee*"; *Diamond* c. *Bank of London & Montreal Ltd.* [1979] 1 All E.R. 561 (C.A.): "*It seems to me that in the case of fraudulent misrepresentation, when it is made by telephone or by telex, as it was here, the tort is committed at the place where the message is received.*"; See also: *Canadian Commercial Bank* c. *Carpenter* (1989), 62 D.L.R. (4^{th}), 734 (B.C. C.A.), p. 741; *B.C.* v. *Imperial Tobacco Canada Ltd.*, 2006 BCCA 398, paras 62, 67-68 (leave to appeal denied, Apr. 5, 2007, SCC no. 31715).

> *fonctionnement et de dissolution, la responsabilité de ses dirigeants et sa représentation.*"[187] [emphasis added]

113. Similarly, leading private international law authors also favour the application of *lex societatis* to govern the delictual liability of corporation's officers for a fault committed in the performance of their duties. They consider that such liability is "accessory to the office" ["*accessoire à la fonction*"] and that it is only logical that the law that creates such office, and defines the powers and duties resulting therefrom, also governs the consequences resulting from a fault in the performance of these very duties.[188] In a recent article, Pr. Cohen wrote:

> "*On sait en effet que la* lex societatis *régit la constitution, l'organisation et le fonctionnement ainsi que la dissolution ou la liquidation de la société. (...) Il apparaît donc logique et cohérent que la responsabilité des dirigeants, rançon de leurs pouvoirs et élément normal du contrôle que peuvent exercer associés ou actionnaires et aussi société, relève de la même loi applicable, à savoir la* lex societatis.
>
> *Les avantages de cette solution paraissent évidents : unité, simplicité, voire même prévisibilité des solutions.*"[189]

114. This solution has been adopted by the French *Cour de Cassation*.[190]

115. The reasoning is entirely transposable to the case of the auditor. The delictual liability of the auditor for a faulty performance of his duties is as much an "accessory to his function and powers" as it is in the case of the liability of a director or managing officer.

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187 J. Talpis et J.-G. Castel, "Inteprétation des règles du droit international privé" in *La réforme du Code civil*, tome III, 1993, P.U.L., p. 838.

188 A. Pillet, *Des personnes morales en droit international privé*, Paris, Sirey, 1914, p. 252; P. Arminjon, *Précis de droit international privé commercial*, Paris, Dalloz, 1948, p. 133; Y. Loussouarn, Note sous Cour d'appel de Douai, (1956) 45 *Revue critique de droit international privé* 490, pp. 495-96.

189 *La responsabilité civile des dirigeants en droit international privé*, (2003) RCDIP 585, pp. 598-99.

190 *S.A. Africatours* v. *Diop*, (1er juillet 1997), reported in (1998) RCDIP 292.

116. The audit has been described as "*one of the cornerstones of corporate governance*".[191] The auditor's function within the company's structure was described by the Supreme Court of Canada (adopting a description by the House of Lords in *Caparo*) in the following terms:

> "*It is the auditors' function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order first, to protect the company itself from the consequences of undetected errors or, possibly, wrongdoing (...) and, second, to provide shareholders with reliable intelligence for the purpose of enabling them to scrutinise the conduct of the company's affairs and to exercise collective powers to reward or control or remove those to whom that conduct has been confided.*"[192]

117. A long line of decisions[193] has held that the auditor has an "*official*" or "*institutional*" role to play within the structure of the corporation with the consequence that he is an *officer* of the corporation:

> "*The Companies Act provides for the appointment of auditors, normally by the company in general meeting and refers to such an auditor as holding "office". The implication is that auditors are appointed and are, whilst they hold office, officers of the company.*"[194] [emphasis added]

118. The provisions of the Act (Castor's *lex societatis*) accord with the above description of the auditor's role and status. The shareholders may elect to appoint a person to the *office* of the auditor (s. 105). The auditor certifies that the financial statements presented to them at the annual general meeting are in accordance with generally

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191 Committee on the Financial Aspects of Corporate Governance (présidé par Adrian Cadbury), *Report of the Committee on the Financial Aspects of Corporate Governance with The Code of Best Practice* (Londres, Gee, 1992), en ligne: www-ecgi.org/codes/documents/cadbury.pdf, para. 5.1, p. 35.

192 *Hercules*, p. 204.

193 *Re London and General Bank*, [1895] 2 Ch. 166 (C.A.); *Re Kingston Cotton Mill Co.*, [1896] 1 Ch. 6 (C.A.); *Bell* v. *Klein*, (1955) 1 D.L.R. 37 (B.C. C.A.); *R.* v. *Shacter*, [1960] 2 Q.B. 252 (C. Crim. A.); *Mutual Reinsurance Co. Ltd.* v. *Peat Marwick Mitchell & Co.*, [1997] 1 Lloyd's L.R. 253 (English C.A.).

194 *Mutual Reinsurance Co.*, *supra* note 193, p. 3.

accepted accounting principles (s. 100). To that end, the auditor must make the examinations that are necessary, in his opinion, to make such report to the shareholders (s. 110). The directors, officers or employees of the corporation are obliged to give him access to the books and records of the corporation and to provide him the information or explanations he needs (s. 111). The auditor is granted qualified privilege (s. 112). Numerous provisions of the Act expressly refer to the "office of the auditor" (cf. s. 105, 106, 107 and 108).

119. While not a "managing officer", the auditor is nevertheless an institutional officer discharging a corporate role. Pr. Rousseau describes the auditor under Quebec law as "*une pierre angulaire de la gouvernance des sociétés*".[195] Similarly, French commercial law authors have described the "commissaire aux comptes" ("the auditor") as an "*organe de la société*" in the same manner as are the directors and shareholders assembly.[196] Authors have recognized that from the standpoint of the application of *lex societatis*, no distinction is to be made between an "*organe de gestion*" and an "*organe de contrôle*", such as the auditor.[197]

120. As mentioned by Pr. Cohen (*supra*, para. 113), the application of *lex societatis* to the liability of corporate officers brings more certainty and predictability, elements that, according to the Supreme Court of Canada, are important in the choice of a rule of conflict.[198] It does so because it applies irrespective of the various places where the directors, managing officers or auditors may happen to perform their corporate

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195 S. Rousseau, "*La gouvernance d'entreprise à la croisée des chemins : comment restaurer la confiance des investisseurs à la suite de l'affaire Enron*" in *Barreau du Québec, Développements récents en droit des affaires*, Cowansville, Yvon Blais, 2003. p. 66.

196 R. Contin, *Le contrôle de la gestion des sociétés anonymes*, Paris, Librairie technique, 1975, pp. 161-62: "*Dès lors que les relations entre le commissaire et la société sont fixées par la loi, le contrôle des comptes prend un aspect institutionnel et le commissaire aux comptes devient un organe aussi nécessaire au fonctionnement de la société que l'assemblée des actionnaires ou la direction*; see also: "G. Ripert & R. Roblot, *Traité de droit commercial*, 16th ed., (by M. Germain), Paris LGDJ, 1996. paras 1335-37 : "*Le commissaire aux comptes est une pièce du mécanisme juridique organisé par la loi. (...) [Les commissaires aux comptes] sont des fonctionnaires de la société investis d'une mission légale de surveillance des comptes.*"

197 Cf. Loussouarn & J.-D. Bredin, *Droit du commerce international*, Paris, Sirey, 1969, para. 378.

198 *Tolofson*, p. 1050.

functions, a factor that is important in the present world of global commerce. In the case at bar, for example, Castor was doing business in many North American and European jurisdictions and the directors, managing officers and the auditor had to perform their duties in various jurisdictions.[199]

121. Moreover, the application of *lex societatis* to auditors' liability makes the same law applicable to both the auditor and the preparers of the financial statements (i.e. the corporation's directors). Subjecting the preparers of the financial statements to *lex societatis* while subjecting the auditor to *lex loci delicti* would inevitably lead to inextricable difficulties and conflicting results.

122. The trial judge flatly rejected the application of *lex societatis* by stating that *any* matter of civil liability of *any* wrongdoer "*is clearly characterized as a matter of civil liability. It is not a matter of status and capacity [....]*" (§3375). With respect, this statement contradicts all of the above-mentioned authorities. Indeed, the <u>only authority</u> the trial judge offers in support of that proposition are various statements contained in an 1976 article by Pr. Talpis which do not offer useful assistance in determining what law applies to the delictual liability of a corporation's officer in the discharge of his duties.[200] Moreover, Prof. Talpis has now unequivocally opted for the application of *lex societatis* to govern the liability of a corporation's officers[201]. Finally, it seems inconsistent for the trial judge to state that "*since Castor was incorporated under the New Brunswick Business Corporations Act, and C&L appointed by the shareholders, various sections of this Act are relevant*" to define C&L's duties (§277), while at the same time finding that the issue of the liability of the auditor (for an alleged breach of these very statutory duties) is a matter that has nothing to do with the law governing the company.

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199 Cf. *supra* para. 40.

200 §3375; J. Talpis, "*Aspects juridiques de l'activité des sociétés et corporations étrangères*", *supra*, note 161.

201 *Supra*, para. 112.

123. While, as the trial judge states, local laws govern a corporation's activities,[202] this has no bearing on the law applicable to the personal liability of the corporation's officers discharging corporate duties within the corporate structure.

124. At the very least, *lex societatis* applies with respect to the 1991 investment, made when Widdrington was already a shareholder and a director of Castor as well as to the issue of the reimbursement of the costs of the settlement with the Trustee. Castor's *lex societatis* governs the internal relationships between the shareholders, the directors and the auditor.[203]

125. For all these reasons, the application, by the trial judge, of *lex loci delicti* instead of *lex societatis* is an error of law. As a consequence, the trial judge wrongly applied Quebec law instead of New Brunswick law, which should be applied to all claims in all Castor files.

126. **Conclusion on conflict of law issue**. Irrespective of what rule of conflict is applied, *lex societatis* or *lex loci delicti*, the conclusion remains the same: the trial judge erred in law when she applied Quebec law rather than Canadian common law principles. The trial judge's failure to first determine the correct law governing Widdrington's claim is an overriding error of law affecting her entire approach, analysis and conclusions.

B) MISAPPLICATION OF *HERCULES* ON INDETERMINATE LIABILITY

127. Under Canadian common law principles, the first element that must be established by a plaintiff who asserts a claim in negligent misrepresentation is the existence of a duty of care.[204]

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202 §3376.

203 *Pickles* v. *The China Mutual Insurance Co.*, [1913] 47 S.C.R. 429; P. Arminjon, *Précis de droit international privé commercial*, *supra* note 188, p. 134.

204 *Queen* v. *Cognos*, [1993] 2 S.C.R. 87, p. 110.

128. The Supreme Court has established in *Hercules* the legal principles that must be applied in order to determine when an auditor owes a duty of care to a third party who relied on his opinion to invest in, or extend credit to, the audited company.[205] The Court established that because numerous persons rely on the audited financial statements in their day-to-day dealings with the audited company, the auditor, in principle, does not owe a duty of care to all of them and in particular to investors or creditors of the audited company: "*in the general run of auditors' cases concern over indeterminate liability will serve to negate a prima facie duty of care*".[206] It is therefore only in exceptional circumstances (when, on the particular facts of a case, the concerns over indeterminate liability do not arise), that the auditor may be found to owe a duty of care to a third party investor or creditor.

129. The trial judge found that the present case was an "exception" to the general class of auditors' liability cases. She considered that Castor was "*a private investment club comprised of closely connected high net worth shareholders and lenders*" *of which Widdrington was a "member*" and that C&L knew that the audited financial statements, Valuation Letters and Legal-for-Life opinions were used by Castor, notably "*to attract and convince new investors to join the 'investment club' (...) or to retain the actual members of said 'investment club'* " (§§3497-99). She concluded that "*the typical concerns surrounding indeterminate liability do not arise*" on the facts of the case (§3515).[207]

130. This reasoning misapplies the principles enunciated in *Hercules*. The "investment club" referred to is not a real "club" with real "members" but only an indeterminate and unidentifiable group of high net worth individuals or corporate entities. Moreover, the trial judge extended the duty of care not only to the actual "members" of the "club", but also to *potential* "*members*" of the "club", which clearly exacerbates the problem of

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205 Campion, Aug. 31, 2009, pp. 39, 84, 88, 151, 152-57; Cherniak, Feb. 24, 2010, pp. 55, 58, 107, 129-30.

206 *Hercules*, p. 197.

207 It is to be noted that §§3510, 3517-26, dealing with the "investment club" argument, are literally adopted by the trial judge from Plaintiff's written argument (at pp. 219-221).

indeterminate liability, as the duty of care would then be extended to literally any person who could invest in, or extend credit to, Castor.

131. With respect, this reasoning is the result of a clear misunderstanding of the principles enunciated by the Court in the *Hercules* decision. In light of their importance for the resolution of the present appeal, these principles must be analyzed in some detail. They are, moreover, best understood in the context of the evolution of the tort of negligence, notably with respect to economic losses.

1) Negligence, economic loss and the "indeterminate liability" problem

132. Before the seminal decision of the House of Lords in *Donoghue v. Stevenson*, in 1932, there was no general recourse in negligence in the law of tort: a plaintiff could only successfully sue in negligence if it had a contract with the defendant.[208] *Donoghue* opened the gate of tortious negligence but restricted the ambit of this liability to "neighbours": a defendant is only obliged to exercise reasonable care not to injure his "neighbour", i.e. a person that is in a special relation of proximity to him. Thus, a fundamental issue in any negligence action in tort is to determine whether the plaintiff has established that the defendant owed him a duty of care.

133. *Donoghue* dealt with negligence in tort causing physical damage, not economic loss. The common law has been very cautious in allowing recovery for economic losses, since, by their very nature, such losses can easily spread beyond what was reasonably foreseeable by the defendant when he acted.[209] Negligent misrepresentation is a typical example[210]. Because a statement can be repeated and disseminated far beyond its intended recipients, there is an inherent danger that the issuer of a statement, if he were to be held liable to everyone who could eventually rely on it, would become

208 Campion, Aug. 31, 2009, pp. 38-39.
209 Campion, Aug. 31, 2009, pp. 41-44, pp. 102-03, 172-75; Cherniak, Feb. 24, 2010, pp. 127-28.
210 Indeed, the English common law did not allow for the recovery of economic loss resulting from negligent misrepresentation until the 1964 House of Lords decision in *Hedley Byrne*.

subject to liability that could be limitless. This is the "indeterminate liability" principle that was famously enunciated by Chief Justice Cardozo in *Ultramares*.[211]

134. *Ultramares* dealt precisely with the issue of whether or not auditors should be liable in negligence to third parties who relied on the audited financial statements to invest in, or extend credit to, the audited corporation. Cardozo J. rejected this view as such liability, if it were recognized, would expose auditors to "indeterminate liability":

> *"If [such liability existed], a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries,* ***may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class."***[212] [emphasis added]

135. The "indeterminacy" issue is not confined to auditor's liability; it is of serious concern in every situation where a person makes a representation on which it is to be expected that numerous persons could eventually rely. As Cardozo J. explained, if the law of negligence extended its protection to all persons that could eventually rely on such opinions, the persons issuing them would become liable, not only to their clients (who paid for the preparation and issuance of the opinion), but to an "indeterminate class" of persons (who did not pay for it). Therefore, the recognition of such a liability would both contravene the rule of privity of contract and subject the defendant to the risk of "indeterminate liability":

> *"Every one making a promise having the quality of contract [would not only] be under a duty to the promisee by virtue of the promise, but under another duty, apart from contract,* ***to an indefinite number of potential beneficiaries*** *(...). 'The law does not spread its protection so far'."*[213] [emphasis added]

211 *Ultramares Corp.* v. *Touche*, 255 N.Y. 170 (1931, NYCA).
212 *Ibid*, p. 444.
213 *Ibid*, p. 448 (references omitted from quotation).

136. The concern to avoid the risk of "indeterminate liability" for the auditor is at the core of the analysis of the Supreme Court in *Hercules*.[214]

2) *Hercules:* no duty of care to investors or creditors

137. The facts of *Hercules* are strikingly similar to Widdrington's claim. From 1971 onwards, Ernst & Young was engaged to perform the annual audits of the two closely-held Manitoba companies which (like Castor) carried on business lending and investing money on the security of real estate. In 1984, the companies went into receivership. The plaintiff shareholders of the companies sued the auditor for the loss in value of their shareholdings and monies invested in reliance on the audited financial statements they alleged had been negligently prepared (pp. 174-176).

138. The defendant auditor brought a motion for summary judgment, claiming it did not owe any duty of care to the plaintiffs. The Manitoba Court of Queen's Bench agreed and summarily dismissed the action. This was confirmed both by the Manitoba Court of Appeal and the Supreme Court of Canada.

139. LaForest J. reiterated that the duty of care in tort is to be determined through the application of a two-part test:

> *"a) is there a sufficient relation of proximity so that, in the reasonable contemplation of the defendant, carelessness on his part may likely cause damage to the plaintiff? (in which case a* prima facie *duty of care arises); and,*
>
> *b) are there any policy considerations which ought to negate or reduce or limit the scope of the duty or the class of person to whom it is owed?"* [p. 184]

140. In the case of negligent misrepresentation, "proximity" will be linked to reliance. Proximity will inhere when: (a) the defendant ought reasonably to foresee that the plaintiff will rely on his or her representation and (b) reliance by the plaintiff would, in

[214] Campion, Aug. 31, 2009, pp. 61, 81; Cherniak, Feb. 24, 2010, pp. 39-40, 129.

the particular circumstances of the case, be reasonable (p. 188). When these two criteria are met, a *prima facie* duty of care arises. It must then be determined whether this *prima facie* duty ought to be negated or limited by policy considerations.

141. In negligent misrepresentation cases, the fundamental policy consideration "*centres around the possibility that the defendant might be exposed to liability in an indeterminate amount for an indeterminate time to an indeterminate class*" (p. 192). For LaForest J., auditors' liability is a case in point:

> "*In the modern commercial society, the fact that audit reports will be relied on by many different people (e.g. shareholders, creditors, potential take-over bidders, investors, etc.) for a wide variety of purposes will almost always be reasonably foreseeable for auditors themselves. Similarly, the very nature of audited financial statements – produced as they are, by professionals whose reputation (and, thereby, whose livelihoods) are at stake — will very often mean that any of those persons would act wholly reasonably in placing their reliance on such statements in conducting their affairs. [...] <u>In light of these considerations, the reasonable foreseeability/reasonable reliance test for ascertaining a prima facie duty of care may well be satisfied in many (even if not all) negligent misstatement suits against auditors and, consequently, the problem of indeterminate liability will often arise</u>.*" (p. 193) [emphasis added]

142. While imposing a broad duty of care upon auditors would act as an incentive to produce accurate audit reports, such an approach would not only bring indeterminate liability for auditors but also a host of undesirable effects on the cost and supply of accounting services (pp. 192-94). Moreover, even though the plaintiff always has to prove negligence and reliance, this would not prevent disgruntled plaintiffs from bringing actions against auditors, actions which would become all the more common if the duty of care were easily recognized. The pressure of such "burgeoning litigation" against auditors would be seriously felt both by the accounting profession and by the courts. The approach of limiting the ambit of the auditor's duty of care is therefore to be

preferred as it *"avoids both "indeterminate liability" and "<u>indeterminate litigation</u>"* (pp. 195-96).[215]

143. As a consequence, *"[i]n the general run of auditors' cases, concerns over indeterminate liability will serve to negate a prima facie duty of care"* (p. 197). While true in most auditors' cases, there may be exceptional situations where the concern over indeterminate liability will not arise. For such an exceptional situation to arise, two conditions must <u>both</u> be met. First, when issuing his statement, the auditor must have known the identity of the plaintiff (or the limited class of potential plaintiffs) that would be relying on his statements. Second, these statements must have been used by the plaintiff for the specific purpose or transaction for which they were prepared by the defendant auditor. If either of these conditions is not present, the concern over indeterminate liability will negate any *prima facie* duty of care of the auditor so that, in the end, the defendant auditor will not be liable to the plaintiff (p. 198).

144. LaForest J. indicated that these two conditions were met in the *Glanzer* and *Hedley Byrne cases*, where a duty of care was found to exist. In *Glanzer*, a weight certificate was negligently prepared. The certificate was prepared for the purpose of a specific transaction for which the weight of some merchandise had to be determined. When he prepared and issued the weight certificate, the defendant weigher knew that the certificate would be given to the plaintiff, who would rely on it for the very purpose of that specific transaction (the sale of the merchandise weighed). Therefore: 1) the identity of the plaintiff was known to the defendant, and 2) the weight certificate *"was used for the 'very end and aim of the transaction' and not for any collateral or unintended purpose. On the facts of Glanzer, (...) then, the scope of the defendant's liability could readily be delimited and, indeterminacy, therefore, was not a concern"*

215 At this point, Defendants cannot help but underline that the Castor litigation (some 97 plaintiffs of all types, including major foreign banks, pension funds, corporate and individual creditors, lenders, investors, directors and from several jurisdictions outside Quebec suing Castor's auditor for a total of more than a billion dollars ($1,058,074,575) in some 80 actions) that has plagued the Quebec judicial system for the last 18 years is precisely the type of "burgeoning indeterminate litigation" that the Supreme Court sought to avoid by restricting the duty of care of auditors towards shareholders, investors and creditors.

(p. 198). In the *Hedley Byrne case*, a credit reference was given directly by the defendant to the plaintiff for the purpose of a specific transaction to be entered into by the plaintiff. LaForest J. indicates that "*while indeterminate liability would have raised some concern to the Lords had the plaintiff not been known to the defendants or had the credit reference been used for a purpose other than that for which it was actually prepared, no such difficulties about indeterminacy arose on the particular facts of the case*" (pp. 198-99).

145. LaForest J. indicated that the same is true of *Haig,* an auditor liability case decided by the Supreme Court in 1977. The defendant-auditor had been retained to prepare audited financial statements for the specific purpose of attracting a $20,000 investment in the corporation from a limited number of potential investors. The Court, while cognizant of the problem of indeterminacy normally arising in the context of auditor's liability, nevertheless found that a duty of care was owed. According to LaForest J., that conclusion was sound as, on the facts of that case, the auditor had been informed of the limited class of persons who would rely on his report and because it was used by the plaintiff for the specific purpose for which it had been prepared by the auditor (i.e. attracting a $20,000 investment in the company). There was thus no risk of "indeterminate liability". Dickson J. (who wrote for the Court in *Haig*) expressed this idea by comparing the fact pattern of *Glanzer* to that of *Ultramares*:

> ***"The case before us is closer to Glanzer than to Ultramares.*** *The very end and aim of the financial statements prepared by the accountants in the present case was to secure additional financing for the company from [a Saskatchewan government agency] and an equity investor;* ***the statements were required primarily for these third parties and only incidentally for use by the company."***[216] [emphasis added]

146. Therefore, in *Haig,* the identity of a <u>limited</u> class of potential plaintiffs was known to the auditor when he issued his opinion and such opinion was used by the plaintiff for the <u>specific</u> purpose for which it had been prepared by the defendant.

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216 Quoted in *Hercules*, at p. 200.

147. LaForest J. then proceeded to apply the foregoing principles to the facts of *Hercules*. He found that there was a *prima facie* duty of care: it was reasonably foreseeable to Ernst & Young that the shareholders could rely on the audited financial statements and such reliance would have been reasonable in the circumstances (pp. 201-02). Proceeding to the second stage of the test, LaForest J. found, however, that the conditions necessary to alleviate the indeterminacy concerns were not present. While the first condition was met (the auditor knew the identity of all the appellant shareholders and thus had knowledge of the identity of the plaintiffs or of a limited class of potential plaintiffs), this was not sufficient. It was also necessary for the plaintiffs to demonstrate that they had used the auditor's statement "*for precisely the purpose or transaction for which it was prepared*". As LaForest J. explained:

> "*The crucial importance of this additional criterion can clearly be seen when one considers that even if the specific identity or class of potential plaintiffs is known to a defendant, use of defendant's statement for a purpose or transaction other than that for which it was prepared could still lead to indeterminate liability.*
>
> *For example, if an audit report which was prepared for a corporate client for the express purpose of attracting a $10,000 investment in the corporation from a known class of third parties was instead used as the basis for attracting a $1,000,000 investment or as the basis for inducing one of the members of the class to become a director or officer of the corporation or, again, as the basis for encouraging him or her to enter into some business venture with the corporation itself, it would appear that the auditors would be exposed to a form of indeterminate liability, even if they knew precisely the identity or class of potential plaintiffs to whom their report would be given.*" (p. 203)

148. What is the specific purpose for which an auditor's report on the financial statements is prepared and issued? In that respect, as seen above (para. 116), LaForest J. referred to what the House of Lords said in *Caparo*, as to the role and function of the auditor and concluded that the specific purpose of a statutory audit is to provide the collectivity of shareholders with reliable financial information to oversee the management and affairs of the corporation. The auditor's report, however, is not prepared for the specific purpose of assisting the shareholders in their individual investment decisions. As the evidence did not show that the statutory mandate of the auditor had been extended or

altered so that the auditor would have also undertaken to take care of any shareholder's individual interests when preparing and issuing his report (pp. 205-07), it followed that the plaintiffs, in relying on the auditor's report for their personal investment decisions, had not used the auditor's report for the specific purpose for which it was prepared. Since one of the two necessary conditions for the "exceptional circumstances" to arise was not present, the risk of indeterminate liability was not alleviated and the defendant auditor did not owe a duty of care to the shareholder plaintiffs, as in most auditors' liability cases. This reasoning applied to the plaintiffs' claims regarding the monies invested in the company by the shareholders in alleged reliance upon the audited financial statements during the relevant period, as well as to plaintiffs' claims based on the loss of the value of their shareholdings (pp. 208-11).

3) *Hercules* applied: no exception for Widdrington or the "Investment Club"

149. In the present case, neither of the two conditions set forth in *Hercules* for the "exceptional circumstances" to arise is present.

(a) Not an identifiable, limited class

150. The first condition is linked to the knowledge, by the auditor *at the time of the issuance of his statement*, of the identity of potential plaintiffs (or of a limited class of potential plaintiffs) that would be relying on it. If the defendant does not know the identity of the potential plaintiffs or of a *limited* class of potential plaintiffs, it is impossible to avoid the risk of indeterminate liability.

151. In light of the purpose and context of this condition, the limited class of potential plaintiffs may not be so broadly defined as to render the condition meaningless or ineffective.[217] In other words, the "class" may not be defined as including *"any person who could eventually happen to receive Castor's audited financial statements"*, or *"any*

217 Cf. *Roy-Nat* inc. v. *Dunwoody*, (1993) BCJ. no. 2152; *Rangen Inc.* v. *Deloitte & Touche*, (1994) CanLII 1555 (B.C.C.A.); *Fraser* v. *Westminer Canada Ltd.*, 2003 NSCA 76; *Mullin* v. *PWC*, 2003 PESCTD 82, paras 33-7, 40.

person who could be approached by Castor for investment in the company or to extend credit to the company" for there would then be no difference between the "class" so defined and the world at large. As stated by Cardozo J. in *Ultramares*, the group of persons who may happen to deal with a company in reliance on the audit report is an "indeterminate class".[218] Indeed the fact that the auditor does not owe a duty of care to all *potential* investors in the audited company has clearly been established by the House of Lords in *Caparo*.[219]

152. The uncontradicted evidence is that when C&L prepared and issued the audit reports on the financial statements, the Valuation Letters or the Legal-for-Life Certificates, C&L was not informed of who would be approached by Castor in any given year to invest in the company or to extend credit to it, and for what amounts.[220] Indeed, at that moment it was not even known *by Castor* who would be approached in any given year to become an investor or extend credit to the company as the pool of investors and creditors was always changing and expanding and as Castor did not know in advance the amounts of investments or loans it would get in any given year and from whom.

153. The present case is therefore the typical situation where the auditor's opinions are used by the company for a host of different transactions and purposes, including convincing third parties to extend credit to the company or to invest in it, as the needs of the company evolve.[221] **To paraphrase Dickson J., we are thus in the situation of *Ultramares*, not in the situation of *Glanzer* or *Haig*.** In *Ultramares,* the auditor knew that the audit report would be used by various persons in their dealings with the company.[222] Indeed, as noted by Cardozo J.:

> *"To finance its operations, [the company] required extensive credit and borrowed large sums of money from banks and other lenders.* ***All this was known to the defendant. The defendant knew also that in the usual course of business the balance sheet when***

218 *Ultramares*, p. 446.
219 *Caparo Industries* v. *Dickman*, (1990) 2 A.C. 605.
220 Wightman, Feb. 10, 2010, pp. 115-19.
221 Simon, Apr. 23, 2009, pp. 135-36, Apr. 27, 2009, pp. 107-11, June 16, 2009, pp. 104-05.
222 Campion, Aug. 31, 2009, pp. 64-65, 74, 81.

> ***certified would be exhibited by the [audited] company to banks, creditors, stockholders, purchasers, or sellers, according to the needs of the occasion, as the basis of financial dealings.*** *Accordingly, when the balance sheet was made up, the defendants supplied the [audited] company with thirty-two copies certified with serial numbers as counterparts originals."*[223] [emphasis added]

154. We are in the same situation. As in *Ultramares*, the auditor does not owe a duty of care to all the *eventual* readers of the audited financial statements, precisely because such would expose the auditor *"to a liability in an indeterminate amount, for an indeterminate time, to an indeterminate class".*[224]

155. As seen above, the trial judge considered that the class of potential plaintiffs was not indeterminate as she found that "*C&L knew that a "distinct group" was relying on its opinions*". This was based on the fact that Wightman described Castor as a kind of "*private investment club comprised of closely connected high net worth shareholders and lenders*". The trial judge stated that "*Wightman's acknowledgement of this limited group shows that the class to which C&L owed a duty, and who was reasonably in their contemplation in the execution of their mandate, is not indeterminate*" (§3517).

156. This reasoning is flawed. The evidence shows that Castor was open (and eager) to obtain money or credit from anyone willing to invest or extend credit to it. Manfred Simon ("Simon") testified that Castor's management always put pressure on the team that was raising revenues to constantly go out and look for new sources of investment or credit, outside the pool of persons or entities that had already invested or extended credit to the company.[225] There is thus no limit and no difference between the public in general and the "club" which could include anyone[226] and, as a consequence, such "club", with such a loose, undefined and ever changing "membership", simply cannot be a limited class of potential plaintiffs within the meaning of *Hercules.* The "investment

223 *Ultramares, supra*, p. 442.
224 *Ibid*, p. 444.
225 Simon, Apr. 27, 2009, pp. 80-82, 107-11.
226 The "club" would include any high net worth individual or entities on the planet, hardly a limited or identifiable class.

club" relied on by the trial judge is simply a figure of speech by Wightman. There is no real "club" with real "members", and no members list or even clearly *identifiable* characteristics. It is an unidentifiable and indeterminate group.

157. The trial judge considered that the duty of care she imposed on the auditor would extend, not only to the "members of the club", but also to the "potential members" of the club. In paragraph 3510, she insisted that the audited financial statements, the Valuation Letters and the Legal-for-Life opinions were widely distributed to "*current and potential shareholders, investors, lenders and depositors*". In paragraph 3524, she stated : "*Wightman considered Castor to be an investment club and the audited financial statements were distributed to and relied upon by the members and the potential members of the club*".

158. As soon as the duty of care extends, not only to actual "members" of the "club", but also to any *potential* "members" of the "club", this means that it would extend to any individual or entity that could eventually be approached by Castor to obtain financing of some sort (shares, debentures, promissory notes, bank or other loans). This is exactly the situation in *Ultramares* and *Caparo* where it was held that there would be no duty of care as such an extended duty in favour of any *eventual* reader of the financial statements or potential investor would inevitably lead to indeterminate liability. Knowledge, on the part of the auditor, that the audited financial statements will be used by the company in a brochure or information memorandum to raise revenue from various sources does not alleviate the indeterminacy concern. Plaintiff's expert Cherniak admitted in cross-examination that "*the class that was spoken of by the Court in Hercules doesn't encompass everybody that might deal with the company (...)*".[227] In *Roy-Nat* inc. *v. Dunwoody*, the BC Supreme Court rejected the idea that a "limited class of plaintiffs" could include all lenders from whom the audited company might borrow money:

[227] Cherniak, Feb. 24, 2010, p. 188.

> *"I think that class too broad. It would be difficult to distinguish that class from one which would included (sic) all creditors who customarily require financial statements before extending credit. It would require considerable dexterity to distinguish major trade creditors from major investors. And so on into indeterminacy."*[228]

159. In the same manner, the British Columbia Court of Appeal stated in *Rangen Inc.*:

> *"Accountants know as a matter of ordinary commercial life that their clients utilize credit in the normal course of business. But unless expressly advised, accountants performing functions as in the case at bar have no way of knowing, and no reason to anticipate, how, when or why any one or more trade creditors will be relying upon financial statements which the accountants have audited."* [229]

160. In her analysis of the "limited class of potential plaintiffs issue", the trial judge also failed to analyze or even mention the recent Supreme Court of Canada decision in *Design Services Ltd.* v. *Canada*[230], although referred to by Defendants' expert Campion in his testimony[231]. In that decision, the Supreme Court of Canada confirmed that the notion of "class of potential plaintiffs" in the context of economic loss cannot be defined in a manner that would still allow the risk of "indeterminate liability". In *Design Services*:

a) subcontractors of the bidder to whom a construction contract should have been awarded sued the owner for the economic losses they suffered as a result of the contract being awarded to a non-compliant bidder;

b) the Court found that there was no *prima facie* duty of care and added that, in any event, a *prima facie* duty of care would have been negated by the concern over indeterminacy (para. 59);

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228 *Roy-Nat Inc.* v. *Dunwoody*, *supra* note 217.
229 *Rangen Inc.* v. *Deloitte & Touche*, *supra* note 217, para. 45, pp. 17-18.
230 2008 SCC 22.
231 Campion, Aug. 31, 2009, pp. 171-75.

c) even though all but one of the plaintiff subcontractors were named in the bidding offer, one was an unnamed subsidiary of a subcontractor which demonstrated that, if a duty was owed to all who could be affected by the owner's decision, this could lead to indeterminate liability:

> *"[I]n cases of pure economic loss, to paraphrase Cardozo C.J., care must be taken to find that **a duty is owed only in cases where the <u>class of plaintiffs</u>, the time and the <u>amounts</u> are determinate**.*
>
> *In the present situation, the subcontractors were identified and (...) could not be substituted without the consent of the [owner]. On its face, this seems to indicate that the class of plaintiffs was determinate. **However, one of the appellants (...) was not named as part of the design-build team at the SOQ stage. Only its parent company (...) was named. This suggests that the class of plaintiffs was not as well defined as found by the trial judge since a subsidiary of one of the design-build team members also made a claim. In my view, since the class of plaintiffs seems to seep into the lower levels of the corporate structures of the design-build team members, this case has an indication of indeterminate liability.**"* (paras 62-63) [emphasis added]

161. If the *Design Services* case has "an indication of indeterminate liability", then the Castor litigation (where the auditor is sued by old and new shareholders, creditors, lenders, bankers and investors for their various dealings with the company *at different times* and for *innumerable transactions* not specifically contemplated by the auditor when he prepared and issued his reports) is clearly a case having all of the "indications of indeterminate liability". The situation in the present case is similar to the British Columbia Court of Appeal's conclusion in *Rangen* in connection with creditors relying on auditor's report:

> *"In short, it is difficult to imagine a clearer case where the imposition of liability would extend in an indeterminate amount for an indeterminate time to an indeterminate class."*[232]

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232 *Rangen Inc.* v. *Deloitte & Touche*, *supra* note 217, para. 48, p. 19.

162. The authorities demonstrate that a "limited class of potential plaintiffs" has to be an *identifiable* class in light of a particular, specific, identified purpose or transaction that is envisaged when the auditor prepares and issues his opinion. In *Haig*, there was a limited class of potential plaintiffs because, even though the identity of the investors was not specifically known by the auditor when he prepared his report, there was however a specific transaction envisaged (the $20,000 investment in the company) for which the audit report was specifically prepared. To the contrary, in *Ultramares* there was no determinate class precisely because there was no specific transaction that was envisaged, even though the auditor knew that the company was using the audited financial statements in its normal, day-to-day dealings with third parties to obtain credit and raise money in a general fashion. This is exactly the situation in the present case.

163. The principles enunciated in *Ultramares*, *Caparo*, *Hercules* and in *Design Services* lead to the inevitable conclusion that, contrary to what the trial judge has found, to recognize a duty of care in the present case to investors or creditors who have read the audited financial statements, Valuation Letters or Legal-for-Life opinions would clearly lead to indeterminate liability as there is no "limited class of potential plaintiffs" that can be linked to any of these representations.

(b) Not used for the specific purpose

164. Under the second condition in *Hercules*, a plaintiff must establish that he used the impugned statement for the specific purpose or transaction for which it had been issued.

165. The trial judge's attempts at distinguishing the present situation from *Hercules* are inconsistent with the law and uncontradicted facts:

a) the evidence establishes that the <u>specific purpose</u> of the audit report was a statutory audit under the Act,[233] as confirmed in the engagement letter.[234] This

[233] S. 100, 110 of the Act.

purpose is described by the Supreme Court in *Hercules* and the House of Lords in *Caparo* as providing Castor's shareholders as a collectivity with relevant information to oversee management at the annual meeting;[235]

b) contrary to the trial judge's inference that *"unlike the financial statements in Hercules, the Castor financial statements were not prepared for a statutory audit since Castor was not obliged by statute to produce audited financial statements"*,[236] nothing in the *Hercules* case indicates that the audited company (privately held) was obliged by statute to have an auditor. In any event, since Castor's shareholders appointed C&L as auditor to conduct a statutory audit, the Act required a statutory audit, C&L's engagement letter mandated a statutory audit and the audit report was addressed and delivered to shareholders for a statutory use;[237]

c) contrary to the trial judge's reliance on the audit reports being used for many purposes including their use as "*a tool that would be relied upon to assess the fair market value of Castor's shares*" (the Valuation Letters) and to produce "*a tool to be relied upon for the issuance of legal-for-life certificates*",[238] incidental use of the financial statements by the company or by others to produce other financial information is common, does not alter the specific purpose for which the audit report is prepared and is consistent with *Hercules* and *Ultramares* recognition of multiple incidental uses of financial statements as the very basis of the problem of indeterminacy. As stated in *Rangen Inc.*:

> *"The uses to which a client may put the audited statements prepared for the purpose of complying with the requirements of the Company Act are legion. In addition to demonstrating to suppliers, present and potential, that the client is creditworthy, copies of the statements may be lodged with term lenders, used by appraisers and others in a*

234 *Supra*, paras 20, 35-37.
235 *Hercules*, p. 204, *supra*, para. 116.
236 At §3523.
237 s. 100 NBBCA, *supra*, paras 16, 20, 21 and 42.
238 §3497.

> *variety of legal proceedings, filed with regulatory agencies to support licence applications or with stock exchanges for listing purposes. The principals of a company may use them as the basis for determining the value of family assets and so on. All these, and many more, are reasonably foreseeable uses. But none constitutes the purpose for which the statements were prepared by an accountant performing the task referred to in s-s. 212(2) of the Company Act. In my view a duty of care does not arise upon reliance for any of the extraneous purposes I have referred to unless the maker of the statements knew, not only of the intended reliance, but accepted the potential risk of reliance.'*[239] [emphasis added]

166. It is the specific purpose for which the audit report was originally prepared *from the point of view of the auditor that counts*, not the other incidental purposes that the company may have for the use of the audited financial statements or other opinions by the auditor. Any other purpose of the company or of a third party, unless adopted by the auditor, is irrelevant.[240] In *Waxman*,[241] the Ontario Court of Appeal decided, on the basis of *Hercules*, that the audit report was not prepared for the additional purpose of taking care of the individual interests of an individual shareholder, even though in that case, the shareholder had personally known and dealt with the auditor for some thirty years.[242]

167. As in *Ultramares*, the fact that the audited financial statements were used *incidentally* by Castor to raise money through the issuance of shares or to obtain loans or renewal of loans (and the fact that such was known by the auditor), does not alter the fact that the specific purpose of the audit report was that of informing the collectivity of shareholders as to the financial situation of the company, not to inform personal investment decisions of investors. Again, we are in the situation of *Ultramares* and *Hercules*, not in the particular situation of *Haig*.

239 *Rangen Inc.* v. *Deloitte & Touche*, *supra* note 217, para. 39, pp. 15-16.
240 Cf. *Roman Corp.* v. *Peat Marwick Thorne,* (1992) 11 O.R. (3d) 248, at pp. 259-60; *Waxman* v. *Waxman*, 2004 O. J. no. 1765 (Ont. C.A.), para. 700.
241 *Waxman*, *supra* note 240, paras 696-701.
242 *Ibid.*, para. 699.

168. In any event, none of the incidental purposes referred to by the trial judge included use by Widdrington for his investment decisions. Nor is there any evidence that C&L knew of or agreed to Widdrington's use of its audit reports. In fact, Widdrington's investment decisions were more than 6 months after the reports and the evidence suggests no one contemplated Widdrington investing at the time they were issued.

169. The specific purpose of the Valuation Letters at issue, as the text and delivery of the letters expressly indicate, was for the information of Castor's directors and "*to update previous letters relating to the valuation of shares prepared at various dates and for the information of the directors*".[243] Further:

a) none were for, delivered to or contemplated Widdrington or his investments;

b) as in *Hercules* delivery or use in one capacity or purpose does not permit other uses in other capacities;

c) Defendants' expert Campion was very clear that the mere knowledge on the part of the auditor of the possible incidental use by the company or others of its opinion does not change the specific purpose of the letter;[244]

d) Widdrington used these Valuation Letters, not as a director under the Restated Shareholder Agreement or for the specific purpose for which they were prepared, but for his own personal investment purposes.

170. Finally, the specific purpose of the Legal-for-Life Certificates was to provide information to Castor's lawyers for the purpose of a legal opinion that would be addressed to Castor and not for any other person or purpose. In any event, such certificates relate to regulatory regimes irrelevant to Widdrington and other *individual* investors or personal investment decisions. As a consequence, any use by Widdrington of these opinions for his own investment purposes would not correspond to the specific purpose for which the Certificates or opinions were prepared.

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243 PW-6-1 (Oct. 17, 1989 and Oct. 22, 1991).
244 Campion, Sept. 1, 2009, pp. 58-59.

171. **Additional comments.** Other elements of the judgment demonstrate a misunderstanding of the principles enunciated by the Supreme Court in *Hercules*:

a) the trial judge states that, in the second part of the test, the court "*has to ask herself whether, in the particular circumstances of this case, there are considerations which ought to negate or limit the scope of the* prima facie *duty*" (§3503). This is not correct. Hercules stands for the proposition that, in principle, any *prima facie* duty of the auditor will be negated by policy considerations, unless we are facing exceptional circumstances where the concerns over indeterminate liability do not arise. The burden is on the plaintiff, not on the defendant;

b) the trial judge states that "*concerns over indeterminate liability have sometimes been overstated*" and refers to paragraph 33 (in fact it is 35) of the *Hercules* decision in this regard (§3530). The Supreme Court of Canada, however, specifically rejected this view and rather considered that taking too liberal an approach to the establishment of the duty of care would not only bring indeterminate liability for the auditor, but also indeterminate litigation for the courts, both undesirable results;

c) the trial judge stated that, on the facts of the present case, "*the court finds that deterrence of negligent conduct is an important policy consideration*" and referred in support to paragraph 35 (in fact 33) of the *Hercules* decision. Again, the Supreme Court rejected this approach: "*in the final analysis, [the deterrence factor in the case of auditor's liability] is outweighed by the socially undesirable consequences to which the imposition of indeterminate liability on auditors might lead.*"[245]

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245 *Hercules*, para. 33.

4) Conclusion

172. Accordingly:

a) there are two necessary conditions established by the Supreme Court to eliminate the risk of indeterminate liability and indeterminate litigation. Neither is present for any of the impugned C&L Representations;

b) the trial judge manifestly misapplied and misinterpreted the principles in the *Hercules* and *Design Services* cases in reaching her conclusion that C&L owed a duty at common law to Widdrington or any investor or creditor.

C) MISAPPLICATION OF QUEBEC LAW REGARDING PROFESSIONAL OPINIONS (ABSENCE OF ANY "LIEN DE DROIT")

173. If Quebec law were to apply to the issue of C&L's liability, as decided by the trial judge, there would be no *lien de droit* between Widdrington and C&L.

174. The trial judge essentially held, on the basis of the *Michaud* and *Mallette* decisions of this Court,[246] that "*when auditors render professional opinions, they assume liability for the consequences of their representations, regardless of the intended purpose of the document*" (§3395).

175. However, other decisions of this Court, notably the recent decision in *Savard*,[247] have established that a professional who renders an opinion for a specific purpose should not be held liable to a third party who was not the intended recipient of such opinion or who relied on it for a purpose different than that for which it was prepared.[248]

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246 *Caisse Populaire de Charlesbourg* c. *Michaud*, [1990] R.R.A. 531; *Agri-Capital Drummond Inc.* v. *Mallette*, [2009] QCCA 1589, paras 28-30.

247 *Supra* note 12.

248 *Placements Miracle inc.* v. *Larose*, (1980) C.A. 287, at pp. 288-89; *Robinson* v. *Barbe*, 2000 R.R.A. 857 (C.A.), paras 47-50; *Caisse Populaire des fonctionnaires* v. *Plante*, (1990) RRA 250 (C.A.), p. 253; *BCIC* v. *General Appraisal of Canada*, (1993) J.Q. 1042 (C.A.), para. 8.

176. Defendants submit that this latter line of decisions should be followed as it accords with the principles enunciated by the Supreme Court of Canada in both the *Houle*[249] and *Bail*[250] decisions. To the contrary, the *Michaud* reasoning, which renders a professional liable to any third party, irrespective of the intended purpose or recipients of the opinion, is not compatible with the principles enunciated in *Houle* and *Bail*, as this is the equivalent of giving to third parties the same rights and the same protections as those given by contract to the client.

177. As the Supreme Court recognized in *Houle* and *Bail*, the mere fact that a party's failure to perform a contractual obligation has caused damage to a third party does not automatically entail delictual liability towards that third party. Such a conclusion would directly contradict the *res inter alios acta* principle, which provides that a contract creates obligations only for the contracting parties (article 1023 CCLC). It is therefore not sufficient for a third-party plaintiff to demonstrate that the defendant has failed to perform its contractual duties:

> *"although contractual and delictual liability may coexist even in the context of a contract, delictual liability must arise <u>independently of contractual obligations</u> and all the elements required to give rise to such liability must be found."*[251] [emphasis added]

178. Thus, a third-party plaintiff cannot claim that a defendant's failure to perform his contractual obligations constitutes *in itself* a fault susceptible of forming the basis for delictual liability. As the Supreme Court made very clear in *Bail*, the violation of a contract does <u>not</u>, in and of itself, constitute a delictual fault:

> *"Dès le départ, il faut écarter l'hypothèse assimilatrice, [selon laquelle] [...] dès lors qu'un manquement contractuel porte préjudice à un tiers, il y a ouverture à responsabilité délictuelle du contractant envers ce tiers."*[252]

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249 *Supra* note 10.
250 *Supra* note 11.
251 *Houle*, at p. 167, quoted with approval in *Bail* at p. 581.
252 *Bail*, at pp. 581 and 584.

179. It must be noted that Quebec law stands on an altogether different footing than French law, which accepts the *hypothèse assimilatrice*. The position of French authors or cases on the issue of whether a contracting party is liable towards non-contracting third parties are thus of no assistance.

180. Quebec law's rejection of the *hypothèse assimilatrice* and refusal to consider a contractual breach as a civil fault giving rise to delictual liability towards third parties is not only in keeping with the principle of the relativity of contracts, it is also well-grounded in logic. To conclude otherwise would lead to inconsistent and unjust results. In the words of Justice Pigeon in *Alliance Assurance Co.* v. *Dominion Electric*:

> *"such a concept of civil responsibility might result in creating in favor of third parties, who are strangers to the contract, obligations more onerous than those enuring therefrom to the contracting party. This would happen whenever an exclusion or limitation of liability is stipulated."*[253]

181. As recognized by the Supreme Court in *Bail*, in order to establish delictual liability resulting from the faulty performance of a contractual obligation, it must therefore be demonstrated that the defendant has breached a <u>legal duty towards the third-party plaintiff</u>:

> *"For a third party, both the existence of a contractual obligation and the failure to perform that obligation are juridical facts, which do not, as such, entitle it to assert any claim. These juridical facts must further fulfill the conditions of delictual liability in the circumstances, in order that such liability may be asserted against the contracting party which has failed to perform its contractual duties. Of these conditions, it is the failure to perform a <u>duty to the third party</u> which may create analytical difficulties here, more so than causality or damages."*[254] [emphasis added]

182. In order to demonstrate that the defendant's conduct in the performance of the contract constitutes a civil fault, the plaintiff must demonstrate that the defendant failed to

253 [1970] S.C.R. 168, p. 173.
254 *Bail*, at p. 581.

behave like a reasonable person towards him. In doing so, the contract's content and the persons to whom the performance of the contract should benefit are relevant circumstances. As the Supreme Court explained in *Bail*, whether a failure to meet a contractual obligation will also be a failure to act like a reasonable person to the third-party plaintiff will depend on whether the contractual obligations in question are stipulated for the sole benefit of the other contracting party or whether they were intended to entail definite benefits for the third party in question:

> *"First, when the obligations set out in the contract entail definite benefits for third parties, be they express or implied, the contracting party must of course avoid causing damage to those third parties. [...]*
>
> *On the other hand, some contractual obligations are stipulated for the exclusive benefit of the other contracting party, and it is then more difficult to imagine how the conduct of the contracting parties could make them liable to third parties."*[255]

183. The question in the present case is thus whether the contractual obligations imposed on C&L were stipulated for the benefit of Widdrington as an investor, or at least whether they were meant to entail "*definite benefits*" for him as an investor. To determine for whose benefit an auditor performs his duties (and the extent of these benefits), it is necessary to determine the purpose for which his obligations were contracted and the identity of the intended recipients of his opinion.

184. In *Savard*, this Court, on the basis of the principles established in *Bail* and *Houle* and reasoning by analogy from the principles established in *Haig* and *Hercules*, stated that a lawyer, like any other professional who issues an opinion, is not necessarily liable to any third party who may happen to rely on it:

> *" En réalité, la faute extracontractuelle d'un avocat résultera d'un manquement à la loi ou de la commission d'une négligence envers une personne à l'endroit de laquelle, dans les faits ou par sa conduite, il a contracté une obligation de prudence ou de diligence.* ***L'avocat, comme d'ailleurs tout professionnel, n'est pas responsable de la perte économique subie par tous ceux qui***

255 *Bail*, at p. 584.

> ***gravitent autour de lui à quelque titre ou quelque occasion que ce soit. Toute autre approche aurait pour effet de lui imposer "a liability for an indeterminate amount for an indeterminate time to an indeterminate class", pour reprendre la phrase célèbre du juge Cardozo dans Ultramares c. Touche. (...)***
>
> *Un avocat pourra donc être responsable de la perte économique résultant d'une activité dite d'affaires subie par un tiers si, en raison des circonstances de l'espèce,* ***la relation professionnelle s'étend au-delà du client pour rejoindre ce tiers et engendrer ainsi une obligation envers celui-ci. Cela signifie, entre autres, que l'acte professionnel est fautif en soi, que l'avocat sait ou devrait savoir que cet acte est aussi destiné à cette autre personne dont la conduite sera nécessairement dictée par cette opinion ou cet avis.*** *Ces quelques critères généraux empruntés aux décisions visant la responsabilité des comptables ne sont pas exhaustifs mais simplement limitatifs (...).*"[256] [emphasis added]

185. Defendants submit that the reasoning of Baudouin J. in *Michaud* (a pre-*Bail* case), adopted by the trial judge, has been superseded by what the Supreme Court stated in *Bail* and what the Court of Appeal concluded therefrom in *Savard*. Baudouin himself has implicitly acknowledged this. In the most recent edition of *La responsabilité civile,* Baudouin and Deslauriers, while of the opinion that common law concepts with respect to accountants' liability should not be imported as such in Quebec law, nevertheless recognize that, in the civil law analysis, an accountant's delictual liability towards third parties will depend on whether the document he prepared was used by its intended recipient and for its intended purpose:

> *"lorsque dans le document une remarque énonce, sans ambiguïté, le but pour lequel il a été confectionné, un tiers pourra plus difficilement l'utiliser pour argumenter qu'il pouvait être destiné à une autre fin.* ***Ainsi, si le document mentionné explique que le rapport est rédigé dans le seul but qu'une compagnie puisse obtenir un financement, un tiers qui aurait acquis des actions sur la foi de ce document ne pourrait utiliser ce rapport pour justifier son recours.***'[257]

256 *Savard,* at p. 2012.
257 J.-L. Baudouin and P. Deslauriers, *La responsabilité civile*, Vol. II ; *Responsabilité professionnelle*, 7th ed., Cowansville, Yvon Blais, 2007, at p. 187.

186. Indeed, as stated above (para. 175), even before the *Savard* case, numerous decisions of this Court had already established that a professional issuing an opinion for a specific purpose should not be liable towards a third party who was not an intended recipient of such opinion or who relied on it for a purpose different than that for which it had been prepared. In light of what the Supreme Court stated in *Bail,* this line of cases should be preferred. Indeed, and significantly, the Supreme Court refused to grant leave in the *Savard* case.[258] It therefore cannot be said that the common law duty of care and the civil law "*lien de droit*" analysis are radically different with respect to auditor's liability towards third parties: a third party who relies on an auditor's statement for a purpose other than that for which the statement was issued will have no recourse against the auditor even if the statement was negligently made.

187. The trial judge held that the *Savard* case was not applicable as it did not deal with auditors' liability but rather with the liability of lawyers, and that a legal opinion is intended for a specific client for a specified purpose, contrary to what would be the case with respect to an opinion issued by an auditor (§§3400-01).

188. This is an error of law for the following reasons.

189. First, while it is true that the *Savard* case dealt with the liability of lawyers, this Court saw fit, in order to determine what principles should be applied to lawyers *vis-à-vis* non-clients, to resort to the principles established in the case of auditors in the same situation. In these circumstances, it would make little sense to limit the principles enunciated in the *Savard* case to the liability of lawyers and not to apply them to auditors.

190. Second, it is not the case that audit opinions are intended for all people and for all purposes while legal opinions are for a specific client and purpose. This is exactly what the *Herculès* case is about: a statutory audit opinion, while it may happen to be read by many persons, is nevertheless made for specific persons and for a specific purpose,

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258 SCC, 2006-03-02, no. 31156.

and it is only with respect to that limited class of persons who have relied on it for that specific purpose that the auditor may be liable. The fact that legal opinions are usually not disseminated to a large public (and this depends on the nature of the legal opinion), does not change the analysis: in order to avoid indeterminate liability, the professional issuing an opinion should only be liable to the persons that were the intended recipients of it and only if they relied on it for the specific purpose for which it was prepared.

191. Finally, if legal opinions are not usually so largely disseminated, it should mean that the concern for indeterminate liability is <u>less</u> acute in the case of lawyers than in the case of auditors. Yet, the trial judge's reasoning necessarily implies that auditors, under Quebec law, are liable "to the whole world", whereas this Court has decided in *Savard* that lawyers should not be, precisely because of the concern over indeterminate liability and in light of the *res inter alios acta* principle, as explained in *Houle* and *Bail.*

192. Defendants submit that there is no reason why, under Quebec law, lawyers should be protected from indeterminate liability by application of the principles enunciated in *Bail*, *Houle* and *Savard* while auditors would not be. Clearly, the reasoning found in the *Houle*, *Bail and Savard* cases offers a way to harmonize the results of the application of the civil law principles of extracontractual liability of professionals *vis-à-vis* non-clients while avoiding the indeterminacy concerns reflected in the Canadian common law principles. It also prevents a situation where Quebec professionals (auditors or others) would be subject to infinite, limitless liability "to the whole world", while their colleagues in the rest of Canada would not be.

193. To the contrary, the *Michaud* reasoning, if adopted, would create a major discrepancy between the rules applicable to Quebec professionals and their counterparts in the rest of Canada, a result that is not desirable in the contemporary world, especially within the framework of the Canadian federation and national professional auditing firms. It is easy to imagine the effect on Quebec auditors if the trial judge's reasoning was maintained: audit opinions would henceforth be prepared and issued in the common

law provinces. This could easily be done as the accounting principles and auditing standards do not vary from one province to another.

194. The principles in *Savard, Bail* and *Houle* require the analysis of C&L's Representations, their intended recipient or beneficiary and their purpose. As indicated above (paras 164 and ff.), in Widdrington's case:

a) the purpose of an auditor's report "*is to provide the shareholders with information for the purpose of overseeing the management and affairs of the corporation and not for the purpose of guiding personal investment decisions or personal speculation with a view to profit*".[259] In the present case, they were specifically addressed to the collectivity of the shareholders for use at the annual meeting, not to Widdrington or for his personal investment decisions;

b) the Valuation Letters were addressed to the directors of Castor to permit them to exercise their duties under the Restated Shareholder Agreement or deal with Castor's affairs and not to assist individuals as investors in their personal investment decisions;

c) the Legal-for-Life Certificates were addressed to Castor's lawyers whose opinions were only relevant to regulated investors mentioned therein and not intended for any individual for personal investment decisions;

d) Widdrington is thus in the position described by Baudouin and Deslauriers and by the Court of Appeal in *Savard* in that he invested in Castor on the basis of reports prepared for others for a different purpose. Widdrington "*ne [peut] utiliser ce rapport pour justifier son recours.*"[260]

195. The trial judge therefore erred in law in favouring the application of the principles stated in *Michaud* (and in misapplying *Mallette*, which is consistent with these submissions as

259 *Hercules*, p. 204.
260 Baudouin and Deslauriers, *supra* note 257, p. 187 (cf. *supra*, paras 16, 20, 21, 42-50).

the report was used by intended beneficiaries for its intended purpose) over those stated in *Savard*. Under these latter principles, as recognized in *Hercules*, Widdrington's claim would be dismissed for the absence of any "*lien de droit*" as he was not an intended recipient of C&L's Representations and did not rely on them for the specific purposes for which they were prepared.

SECTION II - CAUSATION AND DAMAGES (REASONABLE AND DETRIMENTAL RELIANCE, CONTRIBUTORY NEGLIGENCE)

A) THE JUDGMENT

196. Plaintiff's total claim of $2.7 million is composed of three distinct elements:

a) First, for the monies Widdrington invested in Castor in 1989 in order to become one of Castor's directors ($1.1 million);

b) second, for the further monies ($0.3 million) he invested in Castor in 1991 in response to the urgent cash call made by Stolzenberg to deal with Castor's serious liquidity crisis; and

c) third, for the cost of the settlement Widdrington reached with Castor's Trustee ($1.25 million) in respect of two legal actions that were undertaken against him for his breaches of duties as a director of Castor (one for the dividends illegally declared and paid in 1991 and the other for his negligence in discharging his duties as a director).

197. With respect to the claim relating to the investments in Castor, the trial judge concluded that:

a) Widdrington was "*fundamentally misled by the opinions contained in the audited financial statements, valuation letters, and induced to make investments he clearly would not have made without such statements*" (§3330);

b) Widdrington "*was entitled to rely on the presumed knowledge, expertise and professionalism of C&L, who had acted as Castor's auditors since inception, and who had been valuing Castor's shares since 1980*";

c) Widdrington exercised a proper measure of due diligence, as he sought and obtained the advice of three individuals (Prikopa, Taylor and Wood) with considerable experience in financial matters, prior to his investments (§§3336-37); and

d) "*there was no contributory negligence on the part of Widdrington*" (§3575).

198. With respect to the claim for the costs of the settlement, the trial judge indicated that:

a) "*Widdrington would never have been involved with Castor, and would never have been in the position to approve the dividends, but for his reliance on the audited financial statements, valuation letters and Certificates for Legal-for-Life opinions*" (§3583);

b) Widdrington as an "*outside director*" "*had to rely on representations of management and disclosure of auditors for verification of management's representations*" and could discharge his duties as director by having only a general knowledge of the company's affairs (§§3250 and 3344);

c) as a consequence, Widdrington reasonably relied on the audited financial statements when he approved the dividends (§3584);

d) while it might not have been the case for other directors of Castor who had a more extensive knowledge of Castor's affairs, Widdrington "*did discharge his duties as a director of Castor*" and "*acted with care and due diligence in the circumstances*" (§3585);

e) the Defendants had the burden of establishing that the settlement reached with the Trustee was unreasonable; and

f) the settlement was reasonable in the circumstances, particularly since Widdrington might have been the only director with assets in Canada (§§3586-90).

Accordingly, she condemned the Defendants for the reimbursement of the full costs of the settlement.

199. These conclusions result from numerous errors of law. Defendants, for the most part, are not asking this Court to re-evaluate the findings of fact of the trial judge on these issues. Rather, they are asking this Court to reverse the trial judge's conclusions in conformity with proper legal principles.

200. It is to be noted that none of the witnesses addressing reliance testified at the second trial, except Alain Lajoie ("Lajoie") for his cross-examination. Rather, the transcripts of their testimony and/or their written reports were filed in the second trial. Thus, this Court is in the same position as the trial judge to assess the witnesses and the evidence.

201. It is also to be noted that, in many respects, the trial judge adopted literally the Plaintiff's written argument. For example, out of the 21 paragraphs that she devoted to the analysis of the causation issue ("Conclusions", §§3323-44), 17 are entirely or essentially taken from Plaintiff's written argument,[261] resulting in the appearance that the Court did not apply her own analysis to the issues.

B) THE LEGAL PRINCIPLES

202. Under both civil law and common law, the Plaintiff must establish that Widdrington relied, in a reasonable manner, on C&L's Representations and that his losses were not caused by his own negligence.

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261 Compare the judgment with Plaintiff's written argument: §3323 (p. 233); §§3324, 3326, 3327 (p. 284); §3329 (p. 206); §3330 (p. 208); §3331 (p. 209); §3332 (p. 271); §3333 (p. 216); §3334 (p. 205); §§3336, 3337, 3338 (p. 273); §§3340-41 (p. 279); §§3342-43 (p. 285).

203. A plaintiff must first establish *actual reliance* on the misrepresentation, i.e. that, as a matter of fact, he relied on the misrepresentation.[262] This means that the action must fail if the misrepresentation is in respect of elements that were not relied on by the plaintiff. Thus, in the present case, if it were found that the financial statements did not present fairly Castor's financial position in accordance with GAAP on some particular aspect, the Plaintiff must establish that Widdrington relied on that particular aspect of the financial statements. Thus, if he did not consider these aspects or if they were not material to him, he will not have established that he actually relied on the misrepresentation.

204. Second, a plaintiff must also establish that, in the circumstances of the case, his reliance was *reasonable*. Moreover, under New Brunswick, Ontario or Quebec law, where a plaintiff's own negligence has caused or contributed to his loss, the Court shall either dismiss the claim or apportion the damages in proportion to the degree of negligence found against the parties respectively, thus leading to a reduction of the claim.[263] As stated by Linden, in negligent misrepresentation cases: "*the reasonableness of the plaintiff's reliance is (...) critical to the issue of causation in fact; and also relevant on the question of contributory negligence.*"[264]

205. In a case of negligent misrepresentation, the conduct of the plaintiff must therefore be scrutinized to assess whether, first, his reliance on defendant's representation, if any, was reasonable in the circumstances and, second, whether or not he contributed to his loss by his own negligence. Where the plaintiff's conduct is questionable in the circumstances, this may either be a complete bar to his action (if his reliance on the misrepresentation was not reasonable) or, alternatively, will reduce the award of damages in proportion to his fault.[265]

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262 *Hercules*, p. 184.
263 s. 1, *Contributory Negligence Act*, R.S.N.B., c. C-19; s. 3, *Negligence Act*, R.S.O., 1990 c. N-1.
264 *Canadian Tort Law*, 9th ed., p. 452.
265 *Avco Financial Services Realty Ltd. v. Norman*, 2003 O.J. 1255 (Ont. C.A.), paras 30-32; 41-44; *Barings* v. *Coopers & Lybrand*, [2002] EWHC 461 (Ch), paras 31-6.

206. Another element of the tort of negligent misrepresentation is *detrimental reliance*.[266] The plaintiff must establish that he suffered damages as a result of his reliance on the representation. There must therefore be a direct causal link between the misrepresentation and the damages. If the evidence demonstrates that the damages complained of were essentially caused by other factors, or would have been suffered in any event, the misrepresentation is not the cause of the damages.[267]

C) THE TRIAL JUDGE ERRED IN CONDEMNING THE DEFENDANTS TO PAY THE COSTS OF THE SETTLEMENT

207. The trial judge erred in law in assessing Widdrington's conduct according to the subjective standard of the "outside director", which has been rejected by the Supreme Court. When his conduct is assessed against the appropriate objective standard, it is manifest that Widdrington totally failed to discharge his duties as a director of Castor. Consequently, he cannot claim reasonable reliance on the auditor's report on the financial statements, nor shift to the auditor the consequences of his own negligence.

1) The trial judge manifestly erred when she concluded that Widdrington had properly discharged his duties as Director of Castor

208. The trial judge agreed with Plaintiff's attorneys' submissions (based on the Federal Court of Appeal decision in *Soper* v. *Canada*[268]) that Widdrington was only an "outside director" who could discharge his duties by merely relying on the representations of management and of the auditors (§§3250 and 3344). This is a manifest error of law: in *Wise*, the Supreme Court of Canada disapproved *Soper* and rejected the notion that the assessment of the director's conduct should take into account subjective elements.

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266 *Cognos*, p. 89.

267 For Quebec law, see : *Allaire* v. *Girard & Associés*, 2005 QCCA 713, paras 53-62; *C.P. de Charlesbourg* v. *Michaud*, (1990) R.R.A. 531 (C.A.), p. 538; *Irwin Managements Consultants Ltd.* v. *Thorne Riddell*, (1995) R.R.A. 589 (C.A.), p. 594; *Garnet Retallack & Sons* v. *Hall & Henshaw Ltd.*, (1990) R.R.A. 303 (C.A.), pp. 306-07; *Chevrier* v. *Guimond*, (1990) R.R.A. 603 (C.A.), p. 606; *Placements Marcel Lauzon Ltée* v. *Bolduc*, (1997) R.R.A. 310 (C.A.), p. 313; *R.M.A. Restaurant Management* v. *Gallay*, J.E. 96-586 (C.S.).

268 [1998] 1 F.C. 124.

209. In the past, the standard by which a director's conduct was assessed was a subjective one: a director need only exhibit that degree of care and skill that might be expected of a person with the knowledge and experience of the director in question.[269]

210. In *Soper*, the Federal Court of Appeal considered that the text of s. 122(1)(b) of the CBCA still included subjective elements, in light of the expression "*in comparable circumstances*" found at the end of the provision.[270] It stated that the test was "*objective/subjective*". In *Wise*, the Supreme Court of Canada rejected this analysis. The Court observed that the expression "*in comparable circumstances*" does not introduce any subjective elements into the test which remains a purely objective one.[271] By setting aside any subjective component to the standard of care, the Supreme Court of Canada implied that it is incorrect to consider the subjective knowledge of the director under scrutiny, as was done in *Soper*. The director's conduct should not be assessed by what his skills or knowledge happen to be, but rather by what those skills and knowledge *should be*:

> *"Directors and officers will not be held to be in breach of the duty of care under s. 122(1)(b) of the CBCA if they act <u>prudently and on a reasonably informed basis</u>. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or* ***ought to have known***.[272] [emphasis added].

211. The Defendants therefore submit that, in *Wise*, the Supreme Court of Canada interpreted provisions such as s. 79(1) *b*) the Act (*supra*, para. 14) as erasing the traditional distinction between inside directors and outside directors. Indeed, s.79(1) *b*) of the Act subjects "<u>every</u> director" to the reasonable person standard, without introducing any "*subjective element relating to the competence of the director.*"[273]

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269 *Re City Equitable Fire Insurance Company*, [1925] 1 ch. 407, pp. 426-30.

270 *Canada Business Cororations Act*, R.S.C., 1985, c. C-44, s. 122(1)(b): "*(1) Every director and officer of a corporation in exercising their powers and discharging their duties shall [...] (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.*" Compare to 79(1)b of the Act, *supra*, para. 14.

271 *Wise, supra* note 13, para. 63.

272 *Ibid*, para. 67.

273 *Wise, supra* note 13, at para. 62.

212. Therefore, the trial judge erred in law in assessing Widdrington's conduct by the lower subjective standard of the "outside director" rather than by the more stringent and objective criteria set forth in s. 79(1) b) of the Act.

213. In *Housen*,[274] the Supreme Court of Canada stated that, normally, the breach of a standard of care is a question of mixed fact and law reviewable under the standard of palpable and overriding error. However, where a trial court has mischaracterized the applicable standard of care, the breach of that standard is reviewable under the correctness standard.[275] The Defendants submit that this is the case here. When the appropriate standard of care is used, the conclusion that Widdrington totally failed to discharge his duties as a director of Castor is inescapable.

214. In paragraph 3344, the trial judge refers to an extract of Wainberg and Wainberg, apparently to support her view that Widdrington could have properly discharged his duties as director of Castor by having only a very limited knowledge of Castor's affairs. The extract in question clearly reveals, however, that the appropriate standard of care requires much more:

> *"[The director must] keep himself informed as to the policies, business and affairs of the company [and] he must be aware of the functions and acts of the officers and have a general knowledge in the manner in which the business is conducted, the source of its revenues and the employment of his resources."*[276]

Wainberg and Wainberg also indicate that this implies attentiveness, persistence and vigilant activity.[277] In other words, directors must stay informed of the company's activities, policies and affairs and cannot blindly rely on others, whether these people have strong experience or not.[278]

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274 *Housen* v. *Nikolaisen*, [2002] 2 S.C.R. 235.

275 *Ibid*, p. 274.

276 Wainberg and Wainberg, *Duties and responsibilities of Directors in Canada*, CCH Canadian Limited, 6th ed., 1987, p. 18

277 *Ibid.*, p. 19.

278 *Northern and Central Gas Corporation Ltd.* v. *Hillcrest Collieries Ltd. et al.* (1976) 59 D.L.R. (3rd) 533, at pp. 597-599.

215. The case law is clear in this respect. In *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Ltd.*,[279] the Ontario Court of Appeal affirmed a ruling by the Ontario Superior Court that a director fails in his duty of diligence where he or she relies exclusively on experts without exercising any oversight. In *Distribulit Ltd. v. Toronto Board of Education Staff Credit Union Limited*,[280] the Court ruled that even though directors may place trust and faith in the company's officers, trust does not mean blind trust. The failure by directors to ask questions and to follow up when their questions remain unanswered constitutes a failure to properly discharge their duty to exercise reasonable care, diligence and prudence. In *Stroh v. Miller Cove Resources Inc.*,[281] the Ontario Court of Appeal affirmed a ruling by the Ontario Court (General Division) that a director fails in his duty of diligence if he displays a lack of curiosity as to a corporation's affairs. The Paris Court of Appeal stated that:

> *"la responsabilité des administrateurs peut être recherchée lorsqu'ils n'ont exercé aucune surveillance sur la tenue des comptes sociaux ou qu'ils s'en sont purement et simplement remis aux decisions du PDG qu'ils se sont pendant un certain nombre d'années contentés d'entériner."*[282]

216. Therefore, the trial judge erred in applying a lower standard to Widdrington based on subjective considerations which led her to ignore the following evidence.

217. As Castor's business was essentially mortgage lending, discharging his duty as a director meant that Widdrington should have made himself aware of at least the most significant borrowers, loan amounts and risk profiles included in Castor's loan portfolio. Widdrington should have obtained, at a minimum, the kind of information requested in the numerous memos addressed to him by Prikopa before his 1989 investment and prior to each subsequent directors meeting. Not only did Widdrington fail to enquire or raise proper questions as to Castor's business activities, he totally ignored the memos addressed to him by Prikopa during his tenure as director, urging him to obtain proper

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279 (2002) 214 D.L.R. (4th) 496 (Ont. S.C.), at paras 127-59, conf. (2004) 42 B.L.R. (3d) 34 (Ont. C.A.).

280 (1987) 62 O.R. 225 (H.C.J.), at p. 290.

281 [1995] O.J. No. 1376 (Gen. Div.), at paras 4-5, conf Ont. C.A., Court file no. B159/94, p. 2.

282 Feb. 4, 1994 (5274/91)

information on Castor's business (notably on the loan portfolio and the risk level of the loans) at every director's meeting that he attended up to March 1992.[283]

218. Widdrington's explanations, that he was following a learning curve and did not want to make waves, are clearly not acceptable. Not wanting to "make waves", is certainly not in line with the role and duty of a director, according to the standards set forth by the Supreme Court in *Wise* and the above-mentioned authorities. In its written argument, Plaintiff described Widdrington's role as director of Castor as *"... insuring that the Company had direction, a game plan and the right people in place to carry it forward, and that this did not require directors to know a great deal about the specifics of the business"* and this was repeated by the trial judge at paragraph 3249 of the judgment. However, the evidence clearly shows that Widdrington knew absolutely nothing of significance about the business and affairs of Castor, including the identity of its main borrowers and the projects for which loans were extended.[284]

219. As mentioned above (para. 77), during his November 9, 1995 discovery, Widdrington gave a number of general answers to questions put to him as to his role as a director of Castor which are quite revealing as to his total failure to know of or enquire into Castor's business and affairs.

220. In his handwritten memo of March 30, 1991, PW-45, in preparation for a Directors' meeting, Prikopa repeated his ongoing concerns about the lack of Information on Castor's business and, in particular, on its overall loan portfolio and how it was managed:

> *"Castor's report is generally legalistic, and does not give much information on its business, in particular on its overall loan portfolio and how it is managed!! i.e. there is no information on the loan portfolio profile, on how bulk of loans are invested, what type of real estate is financed, location of major loans, spreads versus targeted spreads, safety margin of underlying asset-values over loans etc. – no reference to potential loan defaults."*

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283 Widdrington, Nov. 9, 1995, pp. 24-27; Dec. 17, 2004, pp. 46-50, 67-71; *supra*, paras 77-81, 90.
284 Widdrington, Nov. 9, 1995, pp. 41, 47, 49-51, 55, 65, 69.

221. During his December 4, 1997 discovery (*supra*, para. 76), Prikopa testified that he did not receive any feedback from Widdrington regarding this memo. He confirmed his conclusion that the board material did not provide sufficient information in respect of the issues he had raised, which he considered *"...a need to know"* for a director of a company.[285] By March 1991, Widdrington had been a director of Castor for a full year and, at no time whatsoever during Castor's board meetings (or even outside of them) had he yet made a single attempt to obtain the information requested by Prikopa in his memos.

222. Widdrington could not recall having read or discussed the loans involving the YH Group described in the resolutions tabled during the board meetings of October 12, 1990 and March 21, 1991 (PW-13 and PW-14). Although he agreed that it appeared from these resolutions that there was a lot of business transacted between YH and Castor, he testified that he did not know anything about YH at the time nor did he ask.[286] Widdrington also testified at trial that he did not know anything about MEC at the time nor did he ask anyone for information concerning the connection between MEC, Castor and YH.[287] Widdrington could not recall whether he read the resolutions and attached agreements relating to MLV nor did he recall any discussions at board meetings relating to MLV.[288]

223. As stated above, Dennis, a partner at McCarthy Tétrault and Castor's secretary, confirmed in his discovery that Stolzenberg had full authority and that the board did not discuss individual loans or individual loan decisions.[289]

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285 Prikopa, Dec. 4, 1997, pp. 166-68; PW-45.
286 Widdrington, Jan. 5, 2005, pp. 153-55, 165.
287 Widdrington, Jan. 5, 2005, pp. 156-58, 166.
288 Widdrington, Jan. 5, 2005, pp. 187-90.
289 *Supra*, para. 78.

224. Plaintiff's own expert Jarislowsky, co-founder and a director of the Canadian Coalition for Good Governance, confirmed that:

- he would expect a prudent director to know about the company's key officers and employees;[290]

- he would expect a new director to know about the company's major transactions, although not immediately;[291]

- a director who just "*sits there idle*", listens and never asks questions is not doing his job;[292]

- a director of a company such as Castor should "obviously" know the company's main borrowers and projects for which loans are extended;[293]

- if the board material of a mortgage lending company does not disclose information as to the heart of the business, it would be proper for a director to inquire as to the average rates at which money is lent, the profile of the types of loans in the portfolio, the customer profile and where most of the money is sourced;[294]

- it would be proper for a director attending his third meeting to ask for details as to the loan portfolio, the type of real estate the company is financing and the location of the major loans;[295]

- he further added that most of this information should have been made available in the board material.[296]

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290 Jarislowsky, Apr. 5, 2005, p. 22.
291 *Ibid*, p. 22.
292 *Ibid*, pp. 25-26.
293 *Ibid*, p. 26.
294 *Ibid*, pp. 34-35.
295 *Ibid*, p. 35.
296 *Ibid*, p. 36.

225. In his book "*Dans la jungle du placement*", Jarislowsky stated that:

> *En acceptant de siéger à un CA, on ne s'installe pas dans une sinécure honorifique, on rend service à la compagnie et à ses actionnaires. (...) L'administrateur est bien informé et, s'il fait partie du comité de vérification ou des ressources humaines, il est préférable qu'il ait de l'expérience dans ces secteurs. Il connaît les principaux actifs de la société, tant matériels qu'humains."*[297]

226. Lowenstein, another Plaintiff's expert, testified that it was important for Widdrington to know more about Castor as a director than as a shareholder. As to the level of knowledge that a director should have possessed, he would have obtained as much information as he could over time. He would have expected any significant issue or major change to be brought forward by management to the board.[298] When questioned on the duties of a new director, Lowenstein testified that he would carefully read the board materials provided prior to meetings. If he had any questions, he would try to raise them outside the meeting.[299] When questioned about Prikopa's memo dated May 20, 1990, PW-44-1, concerning Castor's previous directors' book, Lowenstein stated that he agreed with Prikopa's statement that the board material pertaining to this meeting did not give enough insight and information on the heart of the business which, in his opinion, was legitimate information that a director should ultimately have.[300] Widdrington was on Castor's board for two years and he never obtained this information.

227. The trial judge therefore erred in law in applying too low a standard to assess Widdrington's conduct, and, as a result, failed to take into account the above-mentioned evidence which clearly shows that Widdrington did nothing of significance to enquire about Castor's affairs and thus totally abdicated his duties as director. With respect, her conclusion that Widdrington discharged his duties as a director of Castor with care and diligence (following a very brief and superficial analysis: §§3247-51) is

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297 D-656, p. 67
298 Lowenstein, March 24, 2005, pp. 80-84.
299 Lowenstein, March 24, 2005, p. 84.
300 Lowenstein, March 24, 2005, pp. 97-100; PW-44-1.

more akin to a "*pétition de principe*" than to a proper analysis of the applicable legal principles and of the evidence.

2) Widdrington cannot shift liability for his breaches of duty to the auditor

228. The trial judge erred in holding C&L liable to Widdrington for the settlement without first considering whether Widdrington was legally entitled to claim a contribution from the Defendants, notably because he should bear the consequences of his own faults.

229. The first question to be examined is whether Widdrington can claim from the Defendants an amount paid to the Trustee based on: a) his own negligence in the discharge of his duties as director, and b) his illegal declaration of dividends.

230. With respect to his negligence as a director of Castor, Widdrington cannot, as a matter of law, shift the consequences of his own negligence to anyone else, including the auditor.

231. In §3583, the trial judge implied that somehow Widdrington's losses in that respect (i.e. the costs of settling with the Trustee) were caused by C&L's Representations, as he would not have been involved at all in Castor but for these Representations. The trial judge saw an appropriate causal link between these misrepresentations on the part of C&L and the costs Widdrington was obliged to pay for his own negligence as a director of Castor. This is a manifest error of law. The law requires that there must always be a direct, logical connection between the plaintiff's losses and the fault of the defendant (the alleged misrepresentation). C&L's Representations could not have been the *cause* of the losses related to the costs of the settlement with the Trustee: there is another fault which is much more closely connected to these losses and which acts as an intervening factor: Widdrington's own negligence in the discharge of his duties as a director.

232. Further, with respect to the dividends, the issue again is to determine if Widdrington can shift his liability to the auditor in spite of his own failure to inquire about the company's affairs, as demonstrated above.

233. Under s. 100 of the Act, the duty to prepare financial statements in accordance with GAAP rests primarily on the directors of the corporation.[301] It is first incumbent on them, and not on the auditor, to make the necessary inquiries and to obtain the relevant information to approve and place before the shareholders, at the annual meeting, financial statements that are in accordance with GAAP. The role of the auditor is to *verify*, for the benefit of the shareholders, if the persons who are *primarily* entrusted with this duty have produced accurate information:

> *"while most authorities on corporate governance make clear that the audit process is necessary to sustain investor confidence in the corporate governance system, the primary obligation with respect to corporate financial statements falls upon the board and management rather than on the auditors."*[302] [emphasis added]

234. According to a basic principle of law, a person who is primarily entrusted with a task (the "primary debtor") does not have a recourse in law against the person who is charged to verify for the benefit of another (the "watchdog")[303] if he has not adequately performed his own task. This is so because the primary duty rests on his shoulders, not on those of the watchdog. This principle, that the "primary debtor" cannot hold the "watchdog" liable for having failed to watch him appropriately, has been recognized by the Supreme Court of Canada in the *Bilodeau*[304] case, and is followed both in the common law jurisdictions and in the civil law of Quebec, notably in the jurisprudence of this honourable Court.[305]

235. The consequence is that a director who fails to discharge his duties to inquire about the company's affairs, notably as to the company's financial position, and who is thus liable

301 See also s. 5000.02 of the CICA Handbook (PW-1419-2A).

302 McGuinness, *Canadian Business Corporation Law*, p. 81.

303 §275.

304 *Bilodeau* v. *Bergeron & Fils Ltée*, [1975] 2 S.C.R. 345.

305 *Travelers Indemnity Co.* v. *Les Laboratoires Ville-Marie*, [1985] C.A. 608; *Eclipse Bescom Ltd.* v. *Soudures d'Auteuil inc.*, [2002] R.J.Q. 855 (C.A.); *Brassard* c. *United Fruits and Produce Terminal Montreal Ltd.*, (1981) C.A. 567; *Suntrack Rentals Ltée* v. *Alta Construction* (1964) Ltée, (1993) R.R.A. 808 (Q.C.A.); *Vancouver (City)* v. *CBA Engineering Ltd.*, 1991 CANLII 560 (BCSC); *Westcoast Transmission Co.* v. *Interprovincial Steel and Pipe Corp.*, (1985) 60 BCLR 368 (BCSC).

to reimburse dividends that he approved when the company was not in a position to pay them, cannot shift his liability to the auditor.

236. Section 80(3) of the Act provides a *bona fide* defence to the director who has relied, *in good faith*, on the financial statements prepared by the management or the auditor's report on same in his decision to approve dividends.[306] This provision is intended to protect the director who is unaware of the real financial position of the company *despite having shown dispatch in the discharge of his duties as director.* It is of no avail to a director who knew or *should have known* about the real financial position of the company.

237. Defendants submit that the conclusions reached by the Honourable Justice Louise Lemelin with respect to another Castor director, Gambazzi, in her July 30, 2008 decision on the Trustee's petition seeking the reimbursement of the dividends paid in 1991 are instructive in that respect.[307]

238. After proceeding with a careful analysis of Gambazzi's role as a director of Castor, Justice Lemelin came to the conclusion that he failed to convince the Court that he had conducted himself as a reasonable and responsible director and she therefore rejected his defence that he had reasonably relied on the auditor's report when he authorized the dividends. She also noted, in particular, that, generally speaking, the evidence revealed that Castor's entire board was entirely passive"... *se limit(ant) à regarder les chiffres sans questionner, contrôler ou vérifier.*"[308]

239. A passive director does not have a defence with respect to illegally declared dividends under s. 80(3) of the Act. He is not entitled, as a matter of law, to shift his liability in that

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306 s. 80(3): *"A director is not liable under section 76 or 79 if he relies in good faith upon (a) financial statements of the corporation represented to him by an officer of the corporation or in a written report of the auditor, if any, of the corporation fairly to reflect the financial condition of the corporation; or (b) a report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by him."*

307 *RSM Richter inc.* v. *Gambazzi*, 2008 QCCS 3437, at paras 73-88, 119 (Appeal dismissed, 2009 QCCA 829).

308 *Ibid*, para. 83.

respect to the auditor as he cannot say that any reliance he may have placed on the financial statements or the auditor's report was reasonable in the circumstances.

240. The courts, both in the common law and civil law jurisdictions, have held that when a person's conduct is particularly reprehensible (or should not be condoned by the court), this leads to a *"fin de non recevoir"* (estoppel) of his claim, even though it may otherwise be valid. In *Airmax Environnement Inc. v. Auger*, Bouchard J. of the Superior Court, on the basis of the *Soucisse*[309] decision of the Supreme Court, held that a *"fin de non recevoir"* barred the claim of a director of a corporation who had totally abdicated his legal duties as such, since the losses complained of would have been avoided if he had discharged his legal duties.[310]

241. Consequently, as a matter of law, Widdrington is not legally entitled to claim contribution from C&L for his breaches of duty.

242. The Defendants respectfully submit that, at the very least, the trial judge erred in not recognizing that Widdrington's negligence contributed directly, if not entirely, to his damage. She failed to impose the correct standard of care when she found that he was not negligent.

D) NO REASONABLE RELIANCE FOR THE 1991 INVESTMENT

243. On October 25, 1991, in response to a cash call to meet a liquidity crisis, and after he had been a director for more than a year and a half, Widdrington invested a further amount of $292,500 in Castor.

244. In her conclusions on reliance for the investments, except for the Legal-for-Life opinions,[311] the trial judge did not distinguish between the 1989 and the 1991

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309 *Soucisse* v. *Canadian National Bank*, [1982] 2. S.C.R. 339.
310 *Airmax Environnement Inc.* v. *Auger*, (2006) QCCS 3634.
311 The trial judge found that Widdrington had not relied on Legal-for-Life opinions for his 1989 investment, but that they were a factor for the 1991 investment (§3236).

investments. She found that Widdrington had relied on the audited financial statements for 1988, 1989 and 1990, as well as on the Valuation Letters, for both *investments* (§§3331-33). She stated that Widdrington sought the advice of three individuals with considerable experience on financial matters (Wood, Taylor and Prikopa) prior to making his *investments* in Castor, thus exercising a proper measure of due care (§3337). She concluded that, given the information that was provided year after year in the audited financial statements, it was reasonable for Widdrington to rely on same for his *investments* in Castor.

245. This is an error of law. The circumstances of each investment are different. The analysis of whether Widdrington reasonably relied on any representation of C&L must take into account the fact that the 1991 investment was made after he had been a director for more than a year and a half, and was thus entrusted, with the other directors, with the primary responsibility of producing the company's financial statements (*supra*, paras 16, 21, 24, 233). What he knew or should have known by then as to the financial situation of Castor must be part of the analysis of the reasonableness of his alleged reliance on the auditor's statements.

246. The 1991 investment was made in response to a letter sent by Stolzenberg to Widdrington on September 25, 1991 calling for $25 million additional capital in light of a "*tremendous change in attitude [of the banks] towards the refinancing of real estate and real estate related activities*". The September letter was accompanied by the interim unaudited financial statements as of June 30, 1991 and by the C&L Valuation Letter of March 6, 1991.[312]

247. Contrary to what the trial judge found (§3238), the price of the shares was established by Castor's directors and not C&L. This error seems to arise from the fact that the trial judge literally adopted the text of Plaintiff's written argument,[313] without realizing that

312 PW-17.
313 Cf. p. 277 of Plaintiff's written argument.

when they stated that the "letter" contained the above quoted statement, they were referring, not to the Valuation Letter, but to the September 25 letter.

248. Prikopa prepared a memorandum on October 6, 1991 (PW-47) which is detailed in paragraph 80 above.

249. The finding of the trial judge, at paragraph 3240, that Prikopa's memo "*concluded that this was a good investment*" totally omits to consider that such conclusion was predicated on the realization of two important conditions: 1) Widdrington should assure himself at the upcoming board meeting that Castor's loan portfolio did not have undue risk and 2) that all other investors were also committed to the added capital. During his discovery, Prikopa testified that he could not recall receiving feedback from Widdrington as to whether he had obtained this information or these assurances. He added that he did not know if all the other investors were also committed to the added capital which, in his opinion, was certainly an important consideration.[314]

250. Confirming that Prikopa's memo was predicated on conditions that needed to be addressed before investing, Widdrington, in accordance with Prikopa's advice, decided to wait until he had attended the upcoming Board Meeting of October 24, 1991 and had the opportunity to discuss the matter with Stolzenberg and the other directors (§3240).

251. The trial judge found that it was at that meeting that Widdrington received the October 22, 1991 Valuation Letter which was, according to his testimony, the critical factor which impelled him to make his second equity investment (§3241). This Valuation Letter referred to the September 30, 1991 unaudited interim financial statements for the calculation of the book value per share.[315]

252. The Chairman's report on other business matters found at page 3 of the minutes of the October 24, 1991 board meeting, PW-51, is set out in paragraph 81 above.

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314 Prikopa, Dec. 4, 1997, pp. 187-89.
315 PW-6-1.

253. Any reasonable person, let alone a director, faced with a report that requires an injection of $50 million to $100 million, would have quickly come to the conclusion that Castor was then experiencing very serious financial problems. It should have been obvious to a director that there had been a material change in Castor's financial position which superseded the 1990 audited financial statements and the September 30, 1991 interim financial statements. These new issues, the September capital call for $25 million and the required capital injection of $50 million, to $100 million were not referenced in the October 22, 1991 Valuation Letter and had not been communicated to C&L.[316]

254. Lowenstein testified that the liquidity problem referred to in the October 24 directors' meeting should have raised questions on the part of the directors.[317] Defendants' expert Donald Morrison ("Morrison") expressed the opinion that it would have been essential for a prudent director to obtain full details on Castor's problems referred to in these minutes.[318] Lajoie also expressed the opinion that Stolzenberg's letter dated September 25, 1991, PW-17, followed by the minutes of the October 24, 1991, board meeting PW-51, amounted to "*red flags*" that Widdrington should have seriously considered before making his last investment.[319] The trial judge did not take this evidence into account.

255. The magnitude of the liquidity problem and the report by Castor's CEO that he had only secured additional capital subscriptions from existing shareholders of $1.5 million in response to his September request should have raised an additional alarm for Widdrington. In these circumstances, any reliance that Widdrington, an experienced director and sophisticated investor, could have placed on the 1990 financial statements audited by C&L or the C&L Valuation Letters of March 6 and October 22 would have been totally unreasonable.

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316 This confirms Wightman's testimony (that the trial judge did not find credible, although there is no evidence to the contrary) that C&L had not been made aware of the cash call when it prepared the October 22 Valuation Letter.

317 Lowenstein, March 24, 2005, p. 127 and PW-51.

318 Morrison, Oct. 4, 2006, pp. 200-30.

319 Lajoie, Oct. 18, 2006, pp. 40-71, PW-51 and PW-17.

256. In *Hub Excavating Ltd. v. Orca Estates,*[320] the British Columbia Court of Appeal found that the trial judge had erred in allowing a claim in negligent misrepresentation to stand. The Court allowed the appeal as it found that it was not reasonable for the plaintiff to rely on the defendants' assertions in circumstances where these assertions had been supplanted by further and more recent information which rendered the original statements obsolete. The same principle applies in the present case.

257. Widdrington testified that the statement found in the October 22, 1991 Valuation Letter to the effect that the real estate slowdown in North America provided Castor with "additional opportunities" had made a strong impression on him. On the face of the letter, that representation came from management and Widdrington, as a director, should have known it or inquired about it (*supra*, paras 212 ff.).

258. Widdrington decided to invest in Castor on October 25, 1991, despite having no confirmation that the other shareholders would be increasing their own investment in the company. In addition, he could not recall asking any questions as to the risks related to Castor's portfolio of loans.[321]

259. At trial, Widdrington gave a positive account of the October 1991 directors' meeting which was quite different from what he testified nine (9) years earlier when he described the mood as somber (*supra*, para. 82).

260. In fact, Widdrington testified at trial that this investment was much riskier than his previous one and that he was "*taking one for the team*" (*supra*, para. 84).[322]

261. Despite this evidence, the trial judge found that "*Widdrington's decision to buy an additional unit in October 1991 was taken in a context where the overall impression about Castor's performance was very positive*" (§3243). This finding is manifestly erroneous and in complete contradiction with all the above-mentioned evidence,

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320 2009 BCCA 167, paras 58 ff.; see also *Avco, supra* note 265.

321 *Supra*, paras 80 and 84.

322 Widdrington, Nov. 9, 1995, pp. 177-78, Q. 806.

including Widdrington's own admissions as to his state of mind when he decided to invest in Castor.

262. The trial judge mentioned the contradictions between Widdrington's assertions at his discovery and at trial, but held that they were "minor" (§3324). With respect, the contradiction described above as to the October 24, 1991 meeting is on a key point of Widdrington's diligence and reliance on C&L's representations.

263. Some of his most serious contradictions involved his knowledge of Trinity's relationship with and economic dependence on Castor. On discovery in 1995, he claimed that he was not "*... aware of any association*"[323] and described his role at Trinity as that of a passive director. Widdrington was contradicted by Trinity's President, James Binch ("Binch"),[324] and by the fact that he had signed all the resolutions approving loans of several millions of dollars extended by CHIO or CH Ireland to Trinity, D-594. At trial, Widdrington conceded that, as at June 1990, he was aware of the relationship described above and at the time of his 1989 investment, he was aware of names such as CHIO mentioned at Trinity meetings.[325]

264. Again, at the very least, and as stated above (*supra*, paras 204, 205, 206, 214, 215, 242), the trial judge should have considered that Widdrington's own negligence caused or contributed to his loss and should have disallowed the claim for his 1991 investment in proportion to such negligence.

265. With respect to the alleged reliance on the Legal-for-Life Certificates, the trial judge stated that while Widdrington did not rely on Legal-for-Life opinions for his 1989 investment, they were a factor in his decision to maintain and increase his investment in 1991 (§3236).

323 Widdrington, Nov. 8, 1995, p. 38.
324 Binch, Oct. 30, 2001, pp. 209-12.
325 Widdrington, Dec. 17, 2004, pp. 143-44.

266. Apart from the fact that Widdrington testified that he only noted Legal-for-Life opinions in passing in the material provided to him as a director,[326] there is no evidence that he actually relied on them for his 1991 investment. In any event, any such reliance would have been unreasonable as Widdrington was clearly not an intended recipient of such opinions, which were only relevant for the entities mentioned therein. Moreover, it was common knowledge that such opinions were inherently unreliable for investment purposes, even for the entities in question. In their introduction to the "*Legal for life Institutional Investment Rules in Canada*", Stikeman Elliott wrote:

> *"We continue to draft general 'legal for life' opinions at the request of issuers and investors alike, but such opinions are inherently inconclusive, ultimately giving little comfort as to the legality of, and no comfort as to the investment quality of, particular vehicles."*[327] [emphasis added]

E) NO REASONABLE RELIANCE FOR THE 1989 INVESTMENT

267. The issue is to determine whether Widdrington relied, on a reasonable basis, on any of C&L's Representations for his 1989 investment.

268. Defendants are not contesting the facts as found by the trial judge on this issue. Rather, they contest the conclusions that were derived from them.

269. First, Widdrington was undoubtedly a very sophisticated investor. This is consistent with the trial judge's description of his background and experience in paragraphs 3118 through 3125 and with her account of the testimony of the experts Lowenstein (§3272) and Morrison (§3296).

270. In addition, Morrison, Lowenstein and Jarislowsky all testified to the very high-quality of Widdrington's team of advisors. Lowenstein mentioned that it was unusual, even for a high net worth investor, to have access to such level of expertise (§3339).

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326 Widdrington, Nov. 30, 2004, pp. 140, 141 and 162.

327 Stikeman, Elliott, *Legal for Life: Institutional Investment Rules in Canada*, 1994, Fifth Ed. Carswell Thomson Professional Publishing, Toronto, p. ix.

271. It is in light of that unusually high level of expertise that the reasonableness of Widdrington's reliance must be assessed.

272. While acknowledging, in §3325, that a high standard of prudence and care should be imposed upon a well-educated individual with a great deal of prior investment and business experience, the trial judge went on to conclude as follows in §3336:

> "*Widdrington relied on the knowledge and advice of those who had more experience than he had; i.e., Wood, Taylor and Prikopa. He was an experienced businessman based on his functions at Labatt and other companies, but certainly not a sophisticated investor in a company such as Castor. He was entitled to rely on the presumed knowledge, expertise and professionalism of C&L, who had acted as Castor's auditors since inception, and who had been valuing Castor's shares since 1980.*" [emphasis added]

273. With respect, this reasoning is flawed.

274. First, it cannot be said that Widdrington was not a sophisticated investor "*in a company such as Castor*". A person is or is not a sophisticated investor, and if he is (as Widdrington was), he should know what information he should obtain before investing in any type of business. This is especially true with respect to Widdrington as the trial judge found that he "*...had a good understanding of financial statements as well as a strong ability to evaluate a wide variety of business situations and investment opportunities. He was also familiar with prudent investment due diligence procedures.*" [emphasis added].[328] In any event, Widdrington sat on the boards of several lending and real estate companies so he clearly had experience in companies like Castor. He was not only on the board of directors at CIBC, but also at other important public companies, some involved in real estate (*supra*, para. 6d)) and Trinity, a Castor borrower. His duty was to make reasonable inquiries.

275. Second, this reasoning seems to imply that, by the mere fact that Widdrington relied on experienced advisors, he acted with due care. With respect, in the circumstances, this

[328] §3121.

is not the question. Rather what is important is whether he followed the advice he received. Widdrington failed to follow the advice of his advisors and therefore, any reliance he might have placed on C&L's Representations was not reasonable in the circumstances.

276. The failure to follow their advice and the haste Widdrington demonstrated to invest in Castor in order to become one of its directors can only be explained by the fact that Widdrington obviously wished to continue and strengthen his business and personal relationship with Stolzenberg and possible opportunities as he retired from Labatt.

277. Widdrington made his first $200,000 investment in Castor in October 1988 (*supra*, paras 61-63) through Stolzenberg without seeing any financial statements or other financial information regarding Castor (§3202).[329]

278. In December 1989, Widdrington had to make an additional investment in order to become a director. The circumstances surrounding that investment are described *supra*, in paragraphs 65 and ff.

279. At the Toronto York Club lunch meeting, Stolzenberg provided Widdrington with a package of documentation as detailed above (*supra*, para. 65). In all the documentation that was provided to Widdrington by Stolzenberg, there are only two representations made by C&L: 1) the auditor's report on the financial statements for the year ended December 31, 1988 and 2) the October 17, 1989 Valuation Letter.

280. Widdrington conceded that the representations contained in the cover letter, PW-10, to the effect that, for the balance of 1989, the company saw *"...a continuation of the favourable trend in evidence in the past"*, were made by Castor and not by C&L. He asserted that they were based on the unaudited financial statements of Castor which,

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329 Widdrington, Dec. 15, 2004, p. 166.

in his mind, would have been reviewed by C&L, an understanding which was based on his erroneous interpretation of the October 17, 1989 Valuation Letter.[330]

281. When questioned about these interim unaudited financial statements, Widdrington admitted that there was no reference to C&L anywhere in the documents.[331] Widdrington conceded that the package of documents given to him by Stolzenberg prior to his investment was not designed to discuss the future, other than Castor's five-year forecast. He also conceded that the reference to the forecast in the letter of December 12, 1989 was a representation by management and not the auditors as he knew that auditors do not report on the future.[332]

1) No reasonable reliance on the 1988 audited financial statements

282. Defendants submit that Widdrington invested in Castor because of the trust he had in Stolzenberg, because he wanted to develop a relationship with him and become a director. Indeed, when Widdrington listed the eight factors which convinced him to become a director of Castor and invest more than a million dollars in the company, the *first five* are related to the good impression he had of Stolzenberg and Castor through various experiences, and none of them have anything to do with any representation by C&L (§3223). He was also impressed by the unaudited financial statements of September 1989 which "looked very good" and by Castor's track record for the last ten years, but the only audited financial statements he had in that respect were for 1988. He did not see any other auditor's report for any previous year.

283. This is corroborated by the facts as found by the trial judge. At paragraph 3231, the trial judge stated that at the time Widdrington decided to Invest in Castor, he was not only looking for an investment, but, as he was seeing his tenure as Labatt's CEO was coming to an end, he was seeking new challenges, as well as new sources of income.

330 Widdrington, Dec. 16, 2004, pp. 58-60.
331 Widdrington, Dec. 16, 2004. pp. 58-60.
332 Widdrington, Dec. 16, 2004, pp. 74-76.

A directorship in Castor provided Widdrington with both directors' fees in the vicinity of $30,000 per year and access to Stolzenberg's network in North America and Europe.

284. The evidence also shows that:

a) despite Prikopa's advice that three units were better from a cash flow perspective, Widdrington purchased four units to reach the required $1 million level to become a director. This demonstrates that the directorship that Stolzenberg was offering him was his primary objective;

b) despite Prikopa's advice to Widdrington that the financial statements did not reveal crucial information regarding Castor's portfolio of loans, and that he should obtain this information before investing, he proceeded without it, which demonstrates that financial information was not material to his decision.

(a) The 1988 audited financial statements were stale-dated

285. At the time of Widdrington's investment in late December 1989, the audited financial statements dated December 31, 1988 were almost a year old. When cross-examined, Lowenstein admitted that if there is a significant delay from the date of the issuance of the audited financial statements and the time of the investment, then there is a considerable element of risk. He reiterated that one has to also look at the history of the company and anything that would have changed the picture.[333] Jarislowsky confirmed that at the time of Widdrington's investment in 1989, the December 31, 1988 audited financial statements were almost a year old and that this was a long period of time.[334] A similar view was expressed by Lajoie:

333 Lowenstein, March 23, 2005, pp. 161-89.
334 Jarislowsky, Apr. 4, 2005, pp. 121-22.

> *"Mais quand je suis rendu dix (10) ou onze (11) mois plus tard, ces états financiers-là veulent plus rien dire pour moi parce qu'on est trop loin de la date où ils ont été préparés."*[335]

286. Sophisticated investors such as Widdrington and his advisors would or should know that stale-dated financial statements were of little value as things may change rapidly in the real estate lending market. Widdrington and his advisors used the much more recent information from the interim financial statements which they reviewed in some detail. Widdrington testified that he was favourably impressed by the interim statements ("*they looked very good to me*").[336]

(b) Widdrington failed to obtain crucial information in spite of warnings

287. On the day he received the documents, Widdrington did not analyze any of the figures. The following day (December 14), he returned to his office in London, Ontario and gave the documentation to Prikopa and Wood for their advice. Prikopa prepared a hand-written memo setting out his preliminary reaction and gave it to Widdrington and Wood on the same day. Widdrington suggested that a conference call be held with Stolzenberg the next day to get answers to their questions (*supra*, para. 68 and ff.).

288. A brief conference call (15-20 minutes) was held on December 15 between Stolzenberg, Prikopa and Wood. They discussed various issues, including the diversification of Castor's loan portfolio and shareholder's exit options. Stolzenberg undertook to provide a copy of the shareholders' agreement and a portfolio analysis. Prikopa then finalized his memorandum to Widdrington (PW-43-1).

289. This memorandum underlined the risks of this investment and contained a long list of risk factors and possible concerns (*supra*, para. 68; PW-43-1).

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335 Lajoie, Nov. 19, 2009, pp. 54-55; see also *Rangen Inc.*, *supra* note 232, para. 46.
336 Widdrington, Nov. 30, 2004, pp. 87-89.

290. Lowenstein admitted that the concerns and risks outlined in Prikopa's memo were valid.[337] Jarislowsky repeated several times that Prikopa's memo was a very good analysis of the major risks in this kind of investment, adding that he did not think he would have done it much better himself.[338] In his memo, Prikopa was basically telling Widdrington that there were two major concerns for which he should obtain more information before investing: the exitability issue and the quality and diversification of Castor's portfolio of loans. On that last issue, of crucial importance for a lender such as Castor, Prikopa testified that financial statements "*don't give you a good sense of what current developments may be happening that may affect future results and you can't gauge that from looking at a set of financial statements.*"[339] In order to know that you have to get information "*on how the company conducts its business, where its loans are.*"[340] He testified why it was necessary to obtain additional information over and above what was contained in the financial statements:

> "*The documents I was looking at were financial summaries, financial statements that provided the financial history and progress of the company, but <u>didn't go into specifically the details of how the company's mortgage portfolio was constructed or what the focus of Castor was in terms of its mortgage portfolio</u>. So, I wanted to get a better sense of what kind of approach does Castor have to the mortgages and some sense of assurance <u>that they are well diversified, so that there is no undue risk in that business</u>.*"[341] [emphasis added]

291. On the following Monday morning, December 18, 1989, Widdrington, Prikopa and Taylor reviewed the memo, PW-43-1, and Prikopa testified that right after this meeting, after having consulted Taylor, Widdrington informed them that he was going ahead with a four-unit investment, and instructed them to call Castor's office and inform them of his decision. Prikopa did so on Monday, December 18, 1989.[342]

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337 Lowenstein, March 24, 2005, pp. 23-25.
338 Jarislowsky, Apr. 4, 2005, pp. 16, 31-32 and 96-97.
339 Prikopa, Dec. 4, 1997, pp. 200-01.
340 Prikopa, Dec. 4, 1997, pp. 200-01.
341 Prikopa, Dec. 4, 1997, pp. 42-43.
342 Prikopa, Jan. 12, 2005, pp. 138-39.

292. Widdrington's decision to invest was taken before any of the information requested by Prikopa from Stolzenberg was received.[343] Widdrington admitted that the Restated Shareholder Agreement was a very important document, as it set out the conditions under which he could dispose of his shares.

293. It was only on December 20, 1989, after Widdrington had decided to invest, that Prikopa received a copy of the Restated Shareholder Agreement, PW-2382, which confirmed the serious restrictions on exitability.

294. Jarislowsky confirmed that the Restated Shareholder Agreement was a very important document to consider *prior* to making an investment since Castor was a private company and that it would set forth the terms and conditions enabling Widdrington to sell his shares.[344] He would have recommended to Widdrington to read this document and seek legal advice on it, prior to making his investment.[345] Lowenstein was of the same opinion[346] and he thought it was "unfortunate" that Widdrington had not read it.[347]

295. Prikopa had also advised Widdrington that the quality and diversification of Castor's loan portfolio was crucial. On Friday, December 22, 1989, Prikopa received a one-page document entitled "Mortgage Portfolio Analysis – December 31, 1988" (PW-10-5) (*supra*, para. 73).

296. Lowenstein testified that this document "definitely" did not provide adequate responses to Prikopa's concerns.[348] Prikopa's concerns as to the quality of Castor's loan portfolio were repeated in all his subsequent memos (cf. *supra*, para. 75).

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343 Prikopa, Dec. 4, 1997, pp. 34-36, Q. 79-82.
344 Jarislowsky, Apr. 4, 2005, pp. 30, 184-85.
345 Jarislowsky, Apr. 4, 2005, pp. 184-85.
346 Lowenstein, March 24, 2005, pp. 61-62.
347 Lowenstein, March 24, 2005, pp. 62-63.
348 Lowenstein, March 24, 2005, pp. 58-60.

297. During his November 9, 1995 discovery, Widdrington testified that:

- he never personally investigated the quality of Castor's loan portfolio, even after he became a director and shareholder of Castor;[349]

- he did not personally look at the issue of matching maturities of mortgages and amounts owed by Castor, as indicated at item 4 of the risk factors listed in the memo;[350]

- he confirmed that, "... *despite the fact that it was a large investment, I also had a lot of other things on my plate at the time and I relied on documents and interpretation of documents by [Prikopa].*" Widdrington totally overlooked the fact that most of Prikopa's comments were in fact questions;[351]

- he confirmed that he did not go back to Castor to try to either satisfy or respond to the concerns raised by Prikopa prior to investing, more particularly those raised at item 5 at page 2 of the memo.[352]

298. In light of these circumstances, it is manifest that Widdrington could not be said to have relied, in a reasonable manner, on the audited financial statements of December 31, 1988 in his decision to invest. The trial judge erred in finding that Widdrington's instructions to transfer the money took place "*after all requested information had been received*" (§3230). This fails to take into account that he had already decided to go ahead on December 18, before even receiving the Shareholders' Agreement and the "portfolio analysis", but also that the information finally received on December 22, 1989 with respect to such "portfolio analysis" was completely inadequate (cf. *supra*,

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349 Widdrington, Nov. 9, 1995, pp. 21-22.
350 Widdrington, Nov. 9, 1995, p. 23.
351 Widdrington, Nov. 9, 1995, pp. 23-24.
352 Widdrington, Nov. 9, 1995, pp. 24-27, see also, *supra*, para. 77.

para. 73). Jarislowsky stated, in his testimony, that as an investor, he would not invest in a company if he could not get the information he requested.[353]

299. In *Avco*,[354] the Ontario Court of Appeal held that a person cannot be said to reasonably rely on a representation when he or she failed to further inquire in a situation that should have raised doubt as to its correctness. The principle applies in the present case: Prikopa warned Widdrington that Castor's financial statements did not adequately inform the reader as to the quality and diversification of its loan portfolio. Widdrington failed to enquire further about this matter, despite having been warned about the risks thereby involved and, unfortunately for him, this risk materialized. He cannot now claim that he reasonably relied on the financial statements in his decision to invest.[355]

2) No reasonable reliance on the October 17, 1989 Valuation Letter

300. A total of 24 Valuation Letters (PW-6-1), were issued by C&L between March 19, 1980 and October 22, 1991. The nature of the mandate given to C&L with respect to such Valuation Letters and their purpose is analyzed in the next section (*infra*, paras 492 ff.). The only one seen by Widdrington before his equity investment of 1989 is the one issued on October 17, 1989, PW-6-1. The methodology set out in that Valuation Letter is basically a multiplication of the book value by a price to equity ratio referred to in the third paragraph at page 5. The book value of the shares mentioned in PW-6-1 was <u>as at September 30, 1989</u>, thus clearly taken from the <u>unaudited interim financial statements</u>, financial information that had not been audited by C&L.

301. The conclusion of the trial judge that by using the word "... *reviewed* ...", C&L associated itself with Castor's financial information (§3067) is manifestly erroneous and a sophisticated investor such as Widdrington should not have been misled by the use of such wording in the context in which it was used and given that the letter was addressed to Castor's CEO, who provided the statements to C&L.

353 Jarislowsky, Apr. 4, 2005, p. 195.
354 *Supra*, note 265.
355 *Strand v. Emerging Equities Inc.*, 2008 ABCA 23, para. 7.

302. Moreover, Widdrington fully understood that the Valuation Letters did not provide much valuable information over and above what was already available in the financial statements, did not address the concerns raised by Prikopa any more than the financial statements, and contained no information on the quality of Castor's loans.[356] Prikopa also understood the limitations of the Valuation Letters. Indeed, as described in paragraph 68, Prikopa obviously would not have raised these questions if the answers could have been found in the October 17, 1989 Valuation Letter.

303. In these circumstances, the conclusions of the trial judge that Widdrington reasonably relied on C&L's representations in his decision to invest and that he acted with care and diligence in that respect, are manifestly unreasonable.

F) Damages

1) Benefit rule

304. In the event that the court finds that Plaintiff can obtain indemnification from the Defendants for Widdringon's investments in Castor, the application of the benefit rule requires that the gains Widdrington obtained by reason of his investments in Castor be deducted from the award of damages. The benefit rule is recognized both in common law and civil law jurisdictions.[357] The evidence clearly shows that Widdrington received significant benefits from his investments in Castor from December 1989 to March 1992. Indeed, an undertaking was filed as Exhibit PW-2388 showing that Widdrington received dividends, interest payments and directors fees aggregating $164,436.10 from his Castor investments between December 1989 and March 1992.[358]

305. In addition to these direct benefits, Prikopa had calculated in December 1989 that the annual cash benefits associated with Widdrington's investment in Castor included the

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[356] Widdrington, Dec. 17, 2004, p. 34.
[357] S.M. Waddams, *The Law of Damages*, Canada Law Book, 201, nos. 15.680 ff.; *Cooke* v. *Suite*, 1995 R.J.Q. 2765 (C.A.), p. 2782.
[358] Widdrington, Jan. 7, 2005, p. 127, as completed by the undertaking filed as PW-2388.

value of two trips to Europe per year estimated at $10,000.[358] The evidence shows that, during his tenure as a director, Widdrington attended three meetings in Zurich, May 8, 1990, May 7, 1991 and February 13, 1992. According to Prikopa's calculation in his December 18, 1989 memo, PW-43-2, Widdrington received an additional value of $15,000 on account of these three trips to Europe.

306. In September 1991, Castor paid Widdrington $61,120 as his share of the dividends illegally declared in 1991,[360] which were subject to separate proceedings by the Trustee and were part of the settlement. This amount must be deducted from his damages since Widdrington should not have received it.

307. Defendants submit that benefits aggregating $179,436.10 should be deducted from the damages should the Court conclude that Widdrington had the right to be indemnified by Defendants for his investments in Castor. It would be unfair if Plaintiff were allowed to get the full refund of Widdrington investments while keeping the benefits thereof at the same time.

2) Interest and additional indemnity

308. The trial judge erred in law when she condemned the Defendants to pay the legal interest and the additional indemnity from the date of service of the action on the amount that Widdrington paid ($600,000) or agreed to pay ($650,000) to settle the actions introduced against him by the Trustee. The claim was introduced in 1994 but the settlement with the Trustee only occurred in 1998.

309. The settlement (PW-39) was executed on March 16, 1998. In accordance with its terms, Widdrington paid to the Trustee $100,000 on March 11, 1998, $250,000 on June 8, 1998 and another $250,000 on September 9, 1998 (PW-39-2). If the Plaintiff's claim for the $600,000 paid by Widdrington is maintained, the interest and additional

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358 See PW-43-2.

360 PW-2388, PW-19, EPW-24, U-12 (provided during the examination on discovery of Widdrington).

indemnity on these payments can only run as of the date they were respectively made. The rest of the claim regarding the costs of settlement refers to an amount that Widdrington agreed to pay to the Trustee, to a maximum of $650,000, in the event of a final judgment in his favour in the present case. This payment has not yet been made and no interest or additional indemnity is therefore payable in that respect.[361]

SECTION III - NEGLIGENCE

1) **Did the trial judge err in determining that the financial statements for 1988-1990 did not fairly present Castor's financial situation in accordance with GAAP and in determining that the Valuation Letters and the Legal-for-Life Certificates were negligently prepared?**

2) **Did the trial judge err in determining that the 1988-1990 audits were not conducted according to GAAS in relation to the specific misstatements that were found, and whether a properly conducted audit would have discovered the misstatements?**

310. The trial judge called this case a "Herculean" task. Plaintiff's written pleadings encompassed 69 separate audit and accounting issues and referred to 184 transactions and/or balances, over at least three years of account. The three accounting and auditing experts (with overlapping mandates) called by Plaintiff did not attempt to simplify the issues.

311. This approach and the massive amount of evidence led to a judgment based on pervasive and reviewable errors. These errors are determinative.

312. Canadian GAAP applied to the financial statements. GAAS applied to the audit work. These were the principles and standards that a reasonably competent professional in

361 . *Liberté TM inc.* v. *Fortin*, 2009 QCCA 477, paras 38-39; *Binet* v. *Montréal (ville de)*, (2001) R.J.Q. 1894 (C.S.), paras 101-02.

similar circumstances was required to apply to the financial statements and which the trial judge had to correctly identify and then apply.

313. Where a judge commits an error of law, that is appealable on the 'correctness' standard. Where a judge identifies the wrong standard, this is an error of law. Where a judge identifies the correct standard to apply, but omits an essential element of the standard, the error is treated as an error of law. Where the correct standard is used, but is misapplied to the facts as found, then the error is still reviewable, but it is a mixed error of fact and law and the standard of review is higher, requiring the error to be palpable and determinative.[362]

314. The trial judge made all three types of errors:

a) she erred in law by, *inter alia*: applying the wrong standards, accepting the content of expert reports as evidence rather than their testimony, disregarding admissions, misconstruing or disregarding contracts, statutes and caselaw, and drawing conclusions that were *ultra petita*;

b) she failed to apply the appropriate standard by, *inter alia*: applying hindsight and selecting between two schools of thought;

c) she misapplied the appropriate standard to the facts by, *inter alia*: reaching conclusions that were inconsistent with her own findings of fact; applying standards inconsistently and disregarding relevant and determinative evidence.[363]

315. Defendants recognize that neither they nor this Court can possibly review each error committed by the trial judge. Using her analysis of 1988 as a template, Defendants will show how these errors undermine the judgment in its entirety.

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362 *Housen, supra* note 274; *supra*, para. 213.
363 *Ford du Canada* v. *Duclos*, (2007) Q.C. C.A. 1541, paras 107, 112, 127-132, 135.

316. The audit reports state that an examination made in accordance with GAAS allowed C&L to reach the opinion that the consolidated financial statements present fairly Castor's financial position in accordance with GAAP. The trial judge found that the financial statements for 1988-1990 were 'materially misleading'. This results in liability only if interpreted as meaning that they did not present fairly Castor's position in accordance with GAAP. Defendants will demonstrate that these conclusions resulted from reviewable errors made by the trial judge.

317. The trial judge further held that C&L did not comply with GAAS in performing its audits of the 1988-1990 financial statements. As a matter of law, this is irrelevant if the trial judge erred in the determination that the financial statements did not present fairly Castor's position in accordance with GAAP (§401).[364]

318. The trial judge found that during 1988-1991, C&L issued 'faulty' Valuation Letters and Legal-for-Life Certificates. Defendants will demonstrate that these conclusions also resulted from reviewable errors.

A) EXPERT EVIDENCE

319. The trial judge found expert assistance to be necessary in order to decide the negligence issue (§3635). She adopted the opinions reached by Plaintiff's experts, Vance, Froese and Rosen. She relied on illegal evidence and made reviewable errors when assessing their credibility and testimony.

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[364] *Dentech Products Inc.* v. *Demed Manufacturing Ltd.*, [2001] B.C.J. No. 207 (B.C.S.C.), paras 88-94, confirmed on appeal [2003] B.C.J. No. 1560 (B.C.C.A.); see Froese, Jan. 12, 2009, pp. 145-46 (as corrected).

1) Illegal evidence

320. The first error made by the trial judge, which should be reversed by this Court, was to allow the Plaintiff to introduce in the second trial six (6) new expert reports,[365] despite Chief Justice Rolland's imposition of the 120-day limit on the Defendants, which was predicated on the commitment made by Plaintiff, through his attorneys, not to introduce, in the second trial, expert testimony not adduced in the first trial. This commitment led to the following statement by the Chief Justice in his September 7, 2007 Order:

> *"Puisque la preuve en demande est complétée, la défenderesse Coopers & Lybrand sait d'ores et déjà la preuve qui sera faite en demande et est donc placée dans une situation privilégiée pour préparer sa preuve en défense."*

The only accounting and auditing expert who testified for the Plaintiff in the first trial was Vance.

321. Given these additional reports and the judge's conclusion that the Court and the parties were bound by the 120 days allocated for each party, the trial judge, by an interlocutory decision rendered on March 4, 2008, implemented the 'Read-in Rule', holding that expert reports would be accepted as evidence of their contents, as if read.[366]

322. This interlocutory judgment should be reversed as it contravenes the well-established rule that the expert's *viva voce* testimony is the evidence, not his report.[367]

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365 Reports by Rosen, Kingston, Cherniak, Froese, O'Neil and Brenner: cf. judgment rendered by the trial judge on Feb. 27, 2008 granting in part the *Requête amendée des défendeurs pour faire rejeter du dossier, en tout ou en partie, certains rapports d'expert*, dated Feb. 13, 2008. This interlocutory judgment was not immediately appealable as it admitted rather than rejected evidence. Defendants are appealing this interlocutory judgment.

366 March 4, 2008, pp. 43-50. This interlocutory judgment was not immediately appealable: it admitted rather than rejected evidence. Defendants are appealing this interlocutory judgment.

367 *125057 Canada inc.* v. *Rondeau*, 2011 QCCS 94; *Massinon* v. *Ghys*, J.E. 98-1195 (C.A.); see also : *Ville de Ste-Foy* v. *Chubb du Canada*, (2000) R.R.A. 265 (C.A.); *Anthony* v. *Williams*, (1975) C.A. 112; *Ali* v. *Cie d'ass. Guardian*, (1999) R.R.A. 477 (C.A.).

323. Moreover, in her decision on the 'Read-in Rule', the trial judge held that each expert would have to testify that he adopts everything in his report and go through each chapter. The attorney for the Plaintiff also indicated that the Plaintiff's experts would go through each chapter of their report in testimony.[368]

324. This did not happen. Vance only testified under oath that he adopted his report with respect to two projects on which he had computed loan loss provisions ("LLPs").[369] Although Vance referred to every chapter of his report, he did not always arrive at the same conclusions in testimony. Froese never testified that he adopted the contents of his report under oath. He frequently changed his conclusions under oath.[370] Rosen never testified that he adopted the contents of his report under oath, and in fact only touched on issues raised in his supplementary report PW-3034 and volume 1 of PW-3033 in chief. Rosen did not testify in chief on the substance of volume 2 of PW-3033 (where he analyzed the loans and computed the LLPs he stated that C&L should have determined were necessary).

325. Moreover, the trial judge expanded the Read-in Rule as she had articulated it. She stated that she would not allow Defendants to question one of their experts on matters already covered by his report.[371]

326. The result of the application of the Read-in Rule is evident from the judgment on the merits, as numerous examples reveal.[372] The trial judge relied on the content of the

368 Vance, March 4, 2008, pp. 43-50.
369 Vance, Apr. 9, 2008, p. 41 re the Toronto and Calgary Skyline Hotels ("TSH" and "CSH").
370 Specific instances are highlighted in context below.
371 Campion, Aug. 31, 2009, p. 35.
372 Eg. Rosen did not present his volume on LLPs; was incapable of replicating his calculations or admitted errors in them (eg. 1988 and 1989 TWTC Rosen, Apr. 8, 2009, pp. 77-207), yet the judge relied exclusively on his report in §§1280 and 1631); omitted assets (Apr. 8. 2009, pp. 67-69); could not identify his source documents (Feb. 25, 2009, pp. 20-29; Apr. 7, 2009, pp. 145-51, 194-97 and 212-23); admitted that his high end calculations were not what an auditor would do or he could not replicate them (Apr. 8, 2009, pp. 209-12; Apr. 7, 2009, pp. 143-51); admitted errors on Meadowlark (Apr. 8, 2009, pp. 207-10 and PW-1053-18, p. 117), but the judge accepted his report (§1631). The general comments made at §§823, 825, 830-31, 996, 1424, 1426, 1431, 1432 and 1707 indicate that the judge relied on Rosen's report for LLPs. Froese indicated that a criticism he made in his report should be withdrawn or

written reports, despite the fact that: 1) there was no actual sworn testimony by the expert adopting the opinion; or 2) the sworn testimony of the expert in question indicated a change in his opinion or conceded that another school of thought was reasonable. The judgment is therefore largely based on unsworn evidence. Because the trial judge concluded that expert assistance was necessary, this is not a case where substitution of her lay opinion can supplement the experts' reports, and the result is the failure by Plaintiff to adduce legally admissible expert evidence.[373]

2) Evidentiary Foundations

327. Although Defendants do not contest the principle that deference is to be paid to a trial judge's appreciation of credibility, appellate review is appropriate where the trial judge's analysis of that evidence is manifestly incorrect or inconsistent.[374] The trial judge made three pervasive errors in this regard:

a) inconsistent analysis of the experts' mandates;

b) failure to apply, as well as the inconsistent application of, the legal criteria she stated were applicable to the expert evidence;[375]

c) failure to consider critical evidence going to credibility.

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nuanced, and ultimately produced a revised report, but those revisions, although extensive, did not capture all the changes he had said were appropriate while testifying (eg. testimony at Froese, Jan. 9, 2009, pp. 98-103 was not reflected in PW-2941-3 vol. 4, p. 7, s. 2.11(2) and p. 83 (revised report p. 84), s. 2.9 (2)). Vance admitted his OSH calculation was not reliable for LLPs (see below para. 463)

373 *Sharbern Holding Inc.* v. *Vancouver Airport Centre Ltd.*, 2011 SCC 23 (May 11, 2011), paras 173 to 178.

374 *Whitehouse v. Jordan*, [1981] 1 All ER 267, 1 WLR 246, 1 BMLR 14, House of Lords, pp. 16-18 where it was held appropriate to overturn a trial judge's assessment of expert evidence as the judge's interpretation of part of the witness's evidence would create an inconsistency with another part, such that if the judge were correct, then the expert was either 'a knave or a fool'.

375 *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235, pp. 257-58.

(a) Mandates

328. The trial judge stated that Plaintiff's experts each received similar mandates, whereas Defendant's experts were assigned different mandates, exclusive of each other (§§321-23). She held that because each defence expert addressed a different aspect, their opinions were "restricted" or "partitioned" (§§361-64 and 401). It is an error of law to interpret this as affecting witness credibility. Parties are entitled to engage different experts with different backgrounds and specialties to comment on different aspects of the litigation.[376]

329. The trial judge was also inconsistent in that she failed to consider that Plaintiff's experts Froese's and Rosen's mandates were just as 'restricted'. Defendants' expert Donald Selman ("Selman") gave an opinion with respect to all the GAAP and GAAS issues relevant to the litigation, except for the calculation of LLPs.[377] This can be compared to Froese, whose report dealt only with the GAAP and GAAS issues in respect of the LLPs, but not the disclosure issues.[378] Yet the trial judge stated that Froese's mandate did not raise issues of restriction (§341).

330. Similarly, Defendants' expert Russell Goodman's ("Goodman") mandate was considered 'restricted' (§§380-81) and Froese's was not, even though neither dealt with financial statement disclosures. It was also considered "restricted" because he did not include all the issues that had been analyzed in the 1998 Price Waterhouse ("PW") report (§317) despite the fact that the 1998 PW report contained numerous volumes, some of which were authored by other PW partners, two of whom had fallen ill or died prior to the commencement of the second trial in 2008.[379] On the other hand, the trial judge accepted Froese's explanation that his new report did not address all the issues

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[376] *Lindhal Estate* v. *Olsen*, 2004 A.J. 967 (Alta, QB); *Rances* v. *Scaplen*, 2008 A.J. 1323 (Alta, QB); *A.H. Coates & Sons* v. *John-Cor Development Ltd.*, (1999) N.B.J. 474); see also *Simard* v. *Larouche*, 2011 QCCA 911, where it was held that having multiple reports on the same issue was contrary to an appropriate administration of justice.

[377] See index of report D-1295.

[378] PW-2941, vol. 1, pp. 1-2.

[379] Goodman, Sept. 3, 2009, pp. 54-55, 108-23; Sept. 15, 2009, p. 66.

that his original report did, because for the first report, he had been part of a team at Doane Raymond ("Doane"), but that the partner who was going to testify had since died.[380] She also did not comment on the fact that Froese did not consider all YH projects[381] despite his acceptance that surpluses on one could offset losses on another (see *infra*, para. 414).

(b) Changes in reports

331. More significantly, the judge was aware[382] that between the filing of his first report in 1997 and his second report in 2008, Vance's opinion had changed, including significant changes to his LLP calculations, in light of evidence that was adduced during the first trial and additional work he had done after 1997. She did not consider that this affected his credibility (§334).

332. Froese also changed his report between 1997 and 2008 regarding a \$20-\$40 million surplus in MEC in 1988, by simply choosing to omit any discussion of this loan in his 2008 report (§1074).

333. On the other hand, the volume of Rosen's report dealing with LLPs was not updated since 1997 and therefore did not consider the evidence adduced since. Rosen testified that additional information had become available, that he had done some work to calculate the impact but had not brought that work to the Court's attention, even though it might change his opinion on individual loans, because it did not change his overall opinion that the financial statements did not meet GAAP.[383] He testified that he was 'clueless' with respect to at least one of the most important projects (D.T. Smith).[384] Rosen could not replicate his calculations or even say what evidence he relied on to

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380 Froese, Feb. 27, 2008, pp. 5-47, esp. 39.
381 Froese, Dec. 4, 2008, pp. 155-56.
382 §§1272-73, 1276, for one example and D-952 for a summary of all LLP changes, as discussed by Vance on Apr. 18, 2008, pp. 97 ff. and Apr. 21, 2008, pp. 6-96.
383 Rosen, Feb. 19, 2009, pp. 232-45.
384 Rosen, Feb. 19, 2009, pp. 62-63.

reach his conclusions.[385] Defendants submit that this is sufficient reason to reject his opinion.

(c) Stated Criteria for Experts

334. An expert should not be selective in the evidence he examines in order to support the party who engaged him (§330). Although she recognized the principle, the trial judge failed to note that:

a) Froese's 2008 report covered a different selection of loans than his 1997 report. He testified that he did not have the time to review all of the YH loans;[386]

b) Rosen did not provide an opinion on numerous points, despite evidence that he was fully aware of them.[387] For example, despite having his staff conduct research into financial statements of other lenders, he did not include the results of that research in his report or testimony;[388]

c) Vance's report contains 58 pages on related-party transactions ("RPTs"), but he did not consider whether Trinity and Castor were related parties.[389]

335. An expert should not advocate for his client (§§325/#2, 330). The trial judge stated that Vance contravened this rule 'sometimes' (no further detail is given as to how and when), but concluded he was credible because there was no evidence that he had an interest in the outcome of the litigation (§331). This is an erroneous application of the standard. Advocacy is distinct from interest:[390] both are relevant but one does not imply

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385 Rosen, Apr. 8, 2009, pp. 35-37; Apr. 7, 2009, pp. 143-51, 212-19.

386 Froese, Jan. 8, 2009, pp. 199-204.

387 Rosen, Feb. 19, 2009, pp. 62-63, 65-67, 239-47.

388 Rosen, Feb. 20, 2009, pp. 220-26. Research done by Defendants' expert Selman on the same topic, which is what Rosen's staff would have found, is at D-1295, Exhibit 1.

389 Vance, July 8, 2008, pp. 145-6, PW-2908 vol. 1, pp. 4-E-1 to 4-E-58.

390 *National Justice Compania Naviera SA* v. *Prudential*, (1993) 2 Lloyd's Rep. 68, aff. [1995] 1 Lloyd's Rep. 455 (C.A.); *United City Properties Ltd.* v. *Tong*, 2010 BSCS 111; *Poulin* v. *R*, (1975) C.A. 682; *1159465 Alberta Ltd.* v. *Adwood Manufacturing Ltd.*, 2010 ABQB 133.

nor exclude the other. Interest is a matter of relationship, whereas advocacy is a matter of attitude. The trial judge's formulation is contrary to law: it is the "interest" of the witness that may be overlooked if he is otherwise impartial, but bias is not excused simply because the expert has no prior relationship with his mandator.[391]

336. An expert should clearly identify matters beyond his expertise (§325/#4). The rationale for this rule is to enable the Court to disregard testimony on such matters, and give more weight to an expert whose expertise and experience is directly related to the matters covered by his testimony.[392] Yet the trial judge failed to do this with respect to the evidence given by Plaintiff's expert witnesses, as set out below.

337. Plaintiff's expert Froese had only one client who was a lender, and only worked on that audit prior to being named a partner in 1991 (§340). He then ceased an active audit practice and fraud detection and forensic investigation became his primary focus. He is a Certified Forensic Investigator with close to 20 years of experience,[393] yet his report did not address fraud (§2859).

338. The trial judge stated that it was not 'decisive' that Vance never audited an entity like Castor, given Castor's uniqueness (§333). First, Castor was a lender, which is not unique. Second, Vance never audited <u>any</u> company whose business was to lend money.[394]

339. Rosen "*...never signed an audit opinion and he has never prepared financial statements for a company that has activities similar to Castor*" but the trial judge concluded that his experience was "*directly applicable*" (§346). In fact, he never performed these services for <u>any</u> client.[395]

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391 *Eli Lilly Canada Inc.* v *Hospira Healthcare Corp.*, [2010] FCA 282.
392 *Érablière R.V.D.* v. *Quebec*, JE 98-2272; *D.R.* v. *R.*, 2011 QCCA 703 para. 43; *R.* v. *Marquard*, [1993] 4 S.C.R. 223, para. 37.
393 PW-2940.
394 Vance, Apr. 16, 2008, pp. 21-24.
395 Rosen, Jan. 28, 2009, pp. 202-07.

340. The trial judge relied on Rosen's testimony in cross-examination on the valuation of properties.[396] Rosen was not competent to provide any opinion on valuation issues: he testified that he had tried and failed to pass the exam required to obtain his CBV (Chartered Business Valuator) designation four (4) times (§352). The trial judge not only drew no adverse conclusion from these failures, but accepted at face value Rosen's explanation that the examiners (all 4 times) were biased against him and held that Defendants were obliged to bring evidence to contradict that explanation.

341. The trial judge referred to Rosen's evidence in which he admitted changing his stated views to suit his audience, including having written something in an expert's report that he did not believe because it was easier than quarrelling with the lawyers (§349), and concluded (§351):

> *"Adapting writings or presentations to the sophistication of a particular audience and the nature of its interest in a topic, that is not at all surprising and that is not the point. The crux of the matter is whether it entails distortion or misrepresentation."*

This is an error of law, as an expert opinion (particularly one which seeks to explain the generally accepted view at a given point in history) should not change to suit an audience.[397] Further, the publications in question all relate to Rosen's opinion on GAAP. Whether his audience were investors, accounting students, CAs, or a court is immaterial. This error led the trial judge to ignore that:

a) many of Rosen's publications that were inconsistent with positions taken in his report and testimony were widely-used accounting textbooks, such that his testimony represented his personal views, not those that were generally accepted, despite his undertaking to provide the latter (§347);

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396 Eg. She cites him in respect of Meadowlark (§1320): *"...there was a difference between the total loan exposure to the property and what a decent appraisal would reveal as the value"*.

397 *National Justice Compania Naviera SA* v. *Prudential*, (1993) 2 Lloyd's Rep 68, aff. [1995] 1 Lloyd's Rep. 455 (C.A.); *Whitehouse v. Jordan*, [1981] 1WLR 246, the expert should be "*uninfluenced as to form or content by the exigencies of the litigation*".

b) the evidence of a witness who takes opposite views in court cases, should be rejected.

342. Had the trial judge consistently applied the standards she identified, Plaintiff's experts' opinions would have been more critically examined and rejected. This would obviously have led to a different conclusion on liability.[398]

(d) Additional Critical Evidence Disregarded

343. Rosen testified during his cross-examination that he was aware that his report contained errors which he had not divulged during his examination in chief. His "excuse" for not making this disclosure, despite the "Read-in Rule" was that he was waiting for Defendants' attorneys to "quiz" him. The trial judge was so disturbed by this admission that she suspended the cross-examination and ordered him to return with a list of known errors. This demonstrates that Rosen was prepared to allow the Court to be misled if Defendants had not managed to catch him[399] and illustrates the fundamental error of law with the 'Read-in Rule' and the prejudice it caused to the Defendants.

344. Rosen filed a supplementary report in 2008 on fraud, which he had not addressed in his 1997 report. He explained that he drafted it because the Defendants raised the fraud defence after he filed the 1997 report. This was misleading. Defendants raised this defence long before 1997.[400]

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398 With respect to Rosen alone, for example, the judge referred to his opinion for LLPs (eg. §§825, 1426, 1707), disclosure of capitalized interest (§§769-772), and the $100 million debenture (§683). On all these matters, it cannot be asserted that the judge would have reached the same conclusion without his opinion. On certain projects, Rosen's opinion is the only one that supports Plaintiff's arguments (i.e. Vance and Froese did not opine or came to a different conclusion), such as the required LLP on TWTC and Meadowlark in all years.

399 Rosen, Feb. 19, 2009, pp. 240-267, especially pp. 241-251; Feb. 20, 2009, pp. 51-71.

400 Plea in 500-05-003843-933, Aug. 30, 1995, paras 134, 138-149; Plea in 500-05-001686-946, July 31, 1996, paras 178, 182-191.

345. Rosen publicly criticized GAAP and GAAS (§350) and had business interests such that the outcome of this litigation is of interest to him (§359). The trial judge stated she would take these facts into account (§§29, 350, 359) but did not.

346. Vance also misled the Court as to when and how he became aware of an appraisal which caused him to withdraw his recommended LLP on one of the projects (TWTC), which had ranged as high as $80 million for 1990. He testified in this trial that he only saw this appraisal for the first time after the first trial was over and he was preparing his updated report for the new trial. In fact, that appraisal had been put to him in cross-examination during the first trial and he had refused to change his opinion despite numerous opportunities to do so in the first trial.[401]

347. While the trial judge noted that "*Vance stated the facts and assumptions on which his opinions were based and* ***more often than not*** *those facts and assumptions are found to exist or to be right, as later discussed in the present judgment.*" (§336) [emphasis added],[402] there is no statement in the judgment as to when his opinions were rejected because the underlying assumptions were not found to be correct. One of Vance's principal assumptions was that if C&L had asked a question of Castor, then they would have received the information he later received from the Trustee.[403] However:

a) this is contradicted by the Plaintiff's evidence and findings of the trial judge;[404]

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401 Vance, Apr. 21, 2008, pp. 152-169.

402 The same comment and error was made regarding Rosen (§360).

403 Vance, Apr. 18, 2008 pp. 73-90, July 8, 2008, pp. 87-88.

404 D-201A; R.B. Smith, Sept. 17, 2008, pp. 16-17, 20-21, 30, 113-16, 130-36, 144-48, 151-53, 222-24, May 15, 2008, pp. 70, 104-114; D-125, D-127, D-129; the OICA judgment, the admissibility of which is under appeal; (cf. *infra*, paras 573 ff.) the finding that Von Wersebe's guarantees on two loans were restricted in scope in 1989 (§1518) contradicts Whiting's confirmation reply to C&L; PW-1053-19, p. 281 E-320 and PW-1053-19, p. 261 E-302; B. Mackay, Aug. 26, 2009, pp. 29-30; PW-1176; Whiting signed a confirmation reply knowing it did not match YH's records (Whiting, Feb. 24, 2000, pp. 101-9) and was willing to assist Castor in keeping its representations to C&L "on an even keel" (D-213) and §2936.

b) Vance admitted that he did not read the testimony of Castor's employees or consider asking for their assistance, as he would expect them to reply differently in a litigation context than they would have in an audit context;[405]

c) The trial judge found that: i) it was unlikely that a document she relied on would have been made available to C&L (§1520); ii) Gambazzi colluded in buying a house for Stolzenberg with Castor's money (§680); iii) Gambazzi lied (§1678); iv) Gambazzi was a recipient of diverted fees (§2065); v) Lemelin J. held that Gambazzi did not tell C&L the truth (§3570); vi) Stolzenberg and Dragonas coerced Walter Prychidny ("Prychidny") into signing a back-dated false document (§2882 and footnotes); and vii) there was no honest preparer of Castor's financial statements (§§378-79);

d) Vance admitted[406] that where more than one version of borrower financial statements exists, he cannot say which one would have been provided;

e) the persons who could have given answers that would reflect Castor's actual position were Dragonas and Goulakos, but the Plaintiff never called them to testify;

f) there is no evidence that McLean & Kerr would have breached their confidentiality obligations and given C&L honest and straightforward answers (cf. §§1806-17, 1837-42);

g) There is no evidence that David Smith would have cooperated with the auditors. For example, he prepared "pumped up" net worth statements at Stolzenberg's request in case C&L asked.[407]

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405 Vance, Apr. 18, 2008, pp. 57-61.
406 Vance, May 12, 2008, pp. 220-21, July 7, 2008, pp. 94-103.
407 D. Smith, March 14, 2000, pp. 222-3; §2028; Froese, Dec. 9, 2008, pp. 65-67. See D-385.

348. Vance was reluctant to admit errors (§339) and despite the trial judge's statement that she would take this into account in the context of specific topics (§§29 and 339), this was not done.

349. Widdrington approved the financial statements and failed to advise C&L of the fact that he, Stolzenberg and Bänziger all sat on the board of Trinity. The trial judge determined that these loans were undisclosed RPTs, yet never considered the impact of the fact that none of Plaintiff's experts commented on them, presumably because of Widdrington's involvement.

3) Conclusion on Experts

350. As a result of these errors in the assessment of the credibility of the experts, individually and cumulatively, the entire judgment on the GAAP and GAAS issues is irretrievably flawed, as the trial judge relied entirely on Plaintiff's experts to the exclusion of Defendants' experts.

B) INCORRECT STANDARDS

351. The trial judge failed to apply the correct standards in concluding that the financial statements were not presented fairly in accordance with GAAP or that the audit was not appropriately conducted under GAAS.[408]

352. *"All experts agree that C&L had to comply with GAAP and GAAS at all relevant time"* (§308). The primary source of these standards is the CICA Handbook which, as the trial judge noted, is adopted pursuant to rigorous and thorough procedures, is regularly updated and is entitled to great deference by the Court. Although there are exceptional circumstances where a court will deviate from recognized professional standards, the trial judge did not make any finding that such circumstances existed (§§264-65, 444). Where a matter is not covered in the Handbook, GAAP also includes principles that are

[408] PW-5-1, tabs 88a, 89a and 90a are the audit reports issued.

generally accepted by virtue of their use in similar circumstances by a significant number of entities in Canada, consistent with the Handbook (§449).

353. Plaintiff's witnesses' admissions as well as the trial judge's own findings of facts as to Castor's business intent or strategy are relevant to her conclusions on the issues of LLPs, cross-collateralization and capitalized interest.

354. The trial judge rejected the commonly accepted lending industry practice of cross-collateralization and failed to consider that although loan security deficiencies existed with respect to some loans looked at individually, when each of the YH and DTS portfolios are considered on a global basis, there were sufficient asset values available in the portfolio to cover these deficiencies.

1) Two Schools of Thought

355. *"It is not the Court's role to choose between two accepted schools of thought within a given profession."*(§266) The appropriate standards are those that were generally accepted by at least one school of thought adopted or applied by reasonable professionals at the time. The trial judge often omitted to refer to testimony of one of the Plaintiff's experts when he agreed with Defendants, thereby breaching this rule (eg. the treatment of future interest, whether cross-collateralization was acceptable under GAAP, capitalized interest and the meaning of 'fairly' in the audit opinion), as explained below.

2) Hindsight

356. Both the law and GAAP agree that hindsight is not to be applied (§§269-70; Handbook cite at §§474-75). However, the judgment is heavily influenced by hindsight. Auditors date their opinion on the date of "substantial completion" of the financial statements and audit work, and this is the last date on which they are actively seeking evidence.[409] The three financial statements at issue in this litigation were substantially completed on

[409] PW-1419-2a Handbook s. 5405.04, 5405.05, 5405.06; Froese, Dec. 4, 2008, pp. 194-197.

February 28, 1989, February 16, 1990 and February 15, 1991 for December 31, 1988, 1989 and 1990.

357. Hindsight occurs in at least four ways in the judgment, and there are over 100 instances of it. Some of these will be highlighted in individual sections, but its general impact is explained in the following paragraphs.

358. The first type of hindsight is reliance (by the trial judge or by the experts whose opinions she accepted) on a document that was not in existence at the time that Castor completed its financial statements.[410] This often happened with respect to borrower financial statements, where the trial judge frequently referred to borrower financial statements "as at" a date prior to the completion of Castor's financial statements but which were prepared later.

359. Second, the trial judge (or the opinions of the experts she accepted) relied on documents which may have existed at the time that Castor completed its financial

[410] This occurred: re fee diversion 1988 (§2072); LLPs all years – Froese, Dec. 4, 2008, pp. 174-80 (§§826, 1427, 1708); LLPs - YH Vance, July 7, 2008, pp. 97-103, PW-1137-2, PW-1137-4 and PW-2908 vol. 3 pp. 8-25, (§§824, 1425, 1705); Rosen's report was issued without footnotes, and when these were added, they referred to documents that were created for the trial long after the events in question – Rosen, Apr. 7, 2009, pp. 34-8, 76, 212-4 (§§825, 1426, 1707); YH Corp. loans 1988 - PW-1058-4 (§§989, 1000), PW-1136-4, PW-1136-5A, PW-1136-5B, PW-1138-1, PW-1138-2, PW-1139, PW-1149 (§§1002, 1007); MEC 1988 – PW-1137-2 (§1071); TSH 1988 – PW-242, PW-444(A), PW-444(B) (§1122); CSH 1988 – PW-466C, PW-465B (§§1149-50); Lambert 1988 (§1123); CSH 1988 - PW-467A (§1165), PW-465B, PW-466C, PW-1086A (§1192); Meadowlark 1988 – PW-1112-17, PW-1112-4 (§1296); YH 1989 – PW-1157 (§1482), PW-1137-4 (§1501); MEC 1989 – PW-565-7C-1 (§1541) TWTC 1989 – PW-1069-14, PW-1069-15, PW-1069-16 (§1605), PW-1161-31 (§§1609-10); Meadowlark 1989 D-1312 p. 254 (§1623); RPTs 1990 PW-292 (§§1648, 2617); YH 1990, PW-1136-5A (§1793), and reliance on Froese PW-2941-3 vol. 4, para. 2.129, which itself is extrapolated from two YH financial statements dated March 8, 1991 as per PW-2941-3 vol. 4, paras 2.127, 2.128 (§1797); Nasty Nine 1990 (§1824) – Alksnis Feb. 8, 2006, pp. 91-2, 96, PW-1064-1 series (§§1832, 1867); TSH 1990 D-825 (§§1909, 1926, 1928), Froese's source documents PW-444A and PW-444B sent by memo PW-444 (§1920); Froese's cash circle analysis relies on post-Feb. 15, 1991 documents – Jan. 27, 2009, pp. 152-155 (§1925); CSH 1990, PW-467E, PW-465B, PW-466C (§§1940, 1941); TWTC 1990 PW-1186A (§1960); Meadowlark 1990 PW-1112-20 (§1973); DTS 1990 PW-2319, D-175 series and Froese (§§2025-8, 2031); GAAS – MEC 1988 (§2483); GAAS CSH 1988, PW-466C, PW-465A, PW-465B (§2508); GAAS – TSH 1990 (§2603); Valuation Letters – all years – (§§3007, 3031, 3068).

statements (often in draft form), but for which there is no evidence that they were in Castor's files at the time.[411] Lenders do not have unfettered access to their borrowers' or to third parties' files to prepare their financial statements and it is the equivalent of hindsight to judge a situation as if they did when they performed their work.

360. Third, the trial judge analysed the financial statements through the prism of what she was told by the witnesses at trial, regardless of whether that testimony contradicted the documents that Castor had access to at the time.[412]

361. A contemporaneous document prepared by the witness is to be preferred to his testimony given many years later that seeks to vary or contradict the document. This is particularly so when the issue is the information available at the earlier date. Similarly, if two versions of a document exist (eg. multiple versions of YH financial statements for the same period), it is necessary to determine which (if any) was available for the preparation of Castor's financial statements.

362. Examples of the trial judge's error in preferring testimony to the contemporaneous documents are found, *inter alia*, with respect to a series of offers[413] which shows the contemporaneous value of the Skyline hotels, MLV, and related management contracts

411 Re LLPs, Froese Dec. 4, 2008, pp. 179-84 (§§826, 1427, 1708); Re LLPs Vance – assumed that whatever was available to him from the Trustee was available at the time – Apr. 18, 2008, pp. 73-90 (§§824, 1425, 1705); Rosen LLPs – Apr. 8, 2009 pp. 40-42 (§§825, 1426, 1707); PW-1148A and it use to support reliability of PW-1149, Froese, Jan. 9, 2009, pp. 98-102; (§§971-3, 988, 1000, 1002, 1004, 1504, 1535, 1546); YH Corp loans – PW-1140.came from YH files – Whiting, Nov. 10, 1999, pp. 176-80 (§1002); PW-1149 for 1989 in reliance on PW-1148A, despite Froese Jan. 9, 2009, pp. 99-105 (§§1483, 1506); PW-1136-5, PW-1140, PW-1165-1 (§1501); PW-1161-17 (§1605); PW-1161-30 Whiting, Dec. 13, 1999, p. 81 (§1609); D-1194 – no evidence when it was received by Castor (§1623); PW-1129 (§§1754, 1756); PW-1137-5 (§1790); PW-1159-6 Whiting, Dec. 2, 1999, pp.148-50 (§1890); PW-1185 Whiting, Feb. 14, 2000, p. 10 (§1891). PW-1108 B was not in Castor's possession until May 1991 (§§1892, 1893, 1895, 1897, 1902, 2623).

412 MLV-1988 (§909) PW-499, PW-499A, PW-499E, PW-499F, D-1034; D-1035; PW-2928; YH Corp – 1988 (§992) D-213, PW-1171-1; TSH, 1988 (§1118 including footnotes); CSH 1988 (§§1167-1168 including footnotes); OSH 1988 (§1211), which is not reconciled with the finding that in 1990, it was bought in exchange for assuming its debt (§1951); MLV 1989 (§§1461-1462, 1473), D-145; DTS 1990 (§2638).

413 PW-499 series and D-1035.

(§§846, 1118, 1461-62 and 1473). These documents were prepared by YHHL's Executive Vice-President Prychidny, a chartered business valuator and chartered accountant (§§135, 137). Defendants acknowledge that Prychidny testified that what he authored at the time was unrealistic. Whether he was truthful when testifying, however, does not address the question as to what Castor was told: the asset values contained in documents he prepared at the time, or what he revealed to the Court 20 years later?

363. In case of an inconsistency, the issue is whether YH was forthright with Castor, or whether the views of those involved changed with time. There is now evidence before the Court that differs from what was then in existence and the rule against hindsight dictates that the trial judge should consider what the preparer of Castor's financial statements would have considered, not what she now determines to be "the truth", using all the powers of a Court to obtain information not normally available to businesses in the ordinary course. As Rosen conceded, if a document is dated after the audit report, it is not applicable to that audit and if it was not available to Castor at the time of the audit, it should not be used.[414]

364. Fourth, in many instances, the trial judge's analysis was clearly influenced by facts that came to light afterwards.[415] A telling example of this is the heavy influence on her judgment of the fact that Castor ultimately went bankrupt, more than a year after the release of the last audit opinion, even though Castor had paid all its debts up to then and its market and financial condition changed rapidly afterwards.[416]

365. Although it seems intuitive that a bankrupt company must have been faring poorly before its collapse, that conclusion is one based on hindsight. Recent spectacular boom-and-busts have demonstrated that corporate fortunes, especially those tied to

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414 Rosen, Feb. 19, 2009, pp. 100-03; Apr. 8, 2009, pp. 15-18.

415 For example, C&L is faulted for failing to identify a concentration risk (§§2455, 2516). PW-1419-6 and Gourdeau, Feb. 20, 2008, p. 28, is uncontested evidence that this became a GAAP disclosure requirement for the first time in 1996.

416 Simon, Apr. 23, 2009, pp. 146-55; *infra*, paras 562-63; see Judge's comments Apr. 18, 2008, pp. 71-72

real estate, can change virtually overnight, and whether a particular company can weather the storm may be a matter of whether its financial backers are willing to wait out the downturn or decide to cut their losses. As Plaintiff's experts explained, changes in the market place subsequent to year end do not mean that the estimate made as at year end is an error, and even the bankruptcy of the entity shortly after an audit does not mean the audit was poorly performed.[417]

366. Looking at Castor's position as at the end of 1990, without hindsight, requires a consideration of its business model, its history of successfully raising funds, and the state of the real estate markets.[418] Castor loaned money to YH and DTS where it did not expect that the borrower would be able to repay from operations. The expectation was that the borrower would repay from refinancing or selling the completed project. Castor's cash cycles were therefore long, as many of its borrowers' projects would normally take many years to bring to the stage where the collateral could be refinanced or sold at market value. Castor's strategy was to continue to support the debtor until the project was completed.[419]

367. As the projects underlying Castor's loans came closer to completion, there would be less demand to fund costs to complete the projects or to fund operating expenses during redevelopment. In addition, the anticipated sale or refinancing of these projects at or after completion would produce significant amounts of cash.

368. By 1990, this cycle was entering a new phase. The DTS projects were advancing, a few had been sold out, and DTS had addressed its excess house inventory surplus by auctioning off the less desirable houses.[420] MEC officially opened in November 1990 and all the remaining costs to complete were estimated to be equal to the undrawn

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417 Froese, Nov. 11, 2008, pp. 227-38; Dec. 9, 2008, pp. 191-93; Rosen, Feb. 20, 2009, pp. 202-05.

418 However, the judge refers to Lapointe's testimony as to the actual timing of the recession (§1637), without referring to his testimony that its length and depth was not recognized until later - Oct. 13, 2009, pp. 193-96.

419 R.B. Smith, May 14, 2008, pp. 126, 175-76, May 15, 2008, pp. 247-49, May 16, 2008, pp. 46-48; *supra*, paras 26-28.

420 PW-1114-14, PW-1114-14A, PW-1116-12, PW-1118-11, PW-1118-12, PW-1119-11, D-195.

portion of the Bank of Montreal facility.[421] The property was being actively marketed for sale (§1887). The TWTC condominium towers were virtually complete, and enough units had been pre-sold to earn a significant profit[422] (§1261). The commercial centre of Hazelton Lanes was complete.[423] Management of the YH Hotels, which had presented continuing problems, was in the process of being moved to a new manager (§§1913, 1914, 1938).

369. Viewed from the vantage point of December 31, 1990, repayment of Castor's loans upon refinancing or sale of any one of these projects would have represented a significant cash injection. The trial judge failed to consider that this would have covered the costs to complete that Castor expected to fund on other projects that it loaned against as well as its expected operating cash needs for 1991, leaving it with a significant net cash position.

370. At crucial points in the judgment, including the conclusions on LLPs, the trial judge referred to "facts as they unfolded" (§§811, 1419, 1698, 2033). That is not the appropriate test and reveals the influence of hindsight on the judgment.

371. Although we now know that Castor's creditors withdrew their support beginning in mid-to-late 1991, precipitating Castor's downward spiral, this was first announced to the board in the last quarter of 1991. Failing to consider whether Castor could reasonably have survived had its financial backers 'stayed the course', as they had always done until then, is application of hindsight.

Documentary Record – completeness and timing of possession

372. The hindsight issue is tied to that of the integrity and completeness of the documents now in the Court record. As indicated in paras 32-34 above, there is no way of knowing

421 The facility was for $125 million of which $107.9 million had been drawn (PW-1102A; Froese, Nov. 26, 2008, vol. 3, pp. 62-63). The costs to complete were $17.5 million (PW-1106C as explained by Froese PW-2941-3, para. 3.93).

422 PW-1069-10; PW-1167-6 note 4 ($775,000 costs to complete in October).

423 PW-1160-29 p. 1

when many documents now in the control of the Trustee were part of Castor's records, and which documents have since disappeared. Although the trial judge stated with respect to various Castor documents noted in the working papers but not found by the Trustee that "nothing is missing" (§§297-98), this is contradicted by other facts found by the trial judge or admitted by Plaintiff's witnesses.[424]

373. Moreover, Vance's "correlation exercise" referred to at §§299-300 expressly dealt only with the accounting records of the European subsidiaries that are now available to the Court, but no similar exercise was done with respect to other Castor business records, including loan documents, correspondence, security files, or borrower information (such as financial statements) that would have been in the files of Castor or its subsidiaries. As a result, there is no evidence that the documents now available to the Court are complete, and in fact there is evidence to the contrary. Any conclusion that assumes such completeness therefore judges the situation on the basis of a different set of facts than those available at the time.

374. It matters. In respect of one project (TWTC), for one year (1990), the consideration by Vance of a single appraisal that he claimed not to have seen during the first trial, caused him to reduce his LLP, which had ranged up to $80 million, to zero.[425]

3) The 1988 financial statements – did they comply with GAAP?

375. Had the trial judge applied the correct standards, she would not have found that Castor's financial statements for 1988 did not present fairly the company's situation in

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424 The following documents were not found in Castor's records by the Trustee, despite years of investigation: i) The loan file for the CFAG loans to YH, despite Vance's testimony that it is 'inconceivable' that no such file existed (May 5, 2010, pp. 75-79; May 4, 2010, pp. 103-10); ii) The loan agreements between CHIFNV and Morocco and Foxfire, totaling $100 million (§666); iii) A pledge agreement in favour of Credit Suisse in 1988 (determined by the judge to have existed in §689); iv) a pledge agreement in favour of Credit Suisse in 1989, that a judge in Ireland ultimately saw (D-582, esp. p. 13); v) Stolzenberg's instructions regarding bank transfers which the Trustee testified he had been told had in fact existed (Gourdeau, Feb. 15, 2008, pp. 124-26, 176-79); and vi) although a pledge agreement between Bank Gotthard and Castor was produced as an exhibit, the Trustee did not find it in Castor's records (§1673).

425 Vance, Apr. 21, 2008, pp. 30-31, 92-94, 170-71; D-952.

accordance with GAAP. As the trial judge's conclusions for 1989 and 1990 are largely derivative of her 1988 conclusions, her conclusions for all three years should be overturned.

(a) Loan Loss Provisions - General Errors

(i) Failure to Properly Define the Errors in the Financial Statements

376. A reviewable error that permeates the judgment is its failure to identify even an approximate amount by which the LLPs were misstated. Vance and Froese testified that the financial statement preparer must make his 'best estimate' of the required provision.[426] The judgment states that the financial statements were "materially misleading" but makes no reference to GAAP and fails to define what was considered to be "material" with respect to each item (§37).

377. The trial judge was unable to conclude as to a specific shortfall/surplus on many of the loans under review because the Plaintiff did not meet his burden to adduce sufficient evidence to enable the trial judge to make that determination on a balance of probabilities. Rather than identify this as a failure to meet the burden of proof or GAAP requirements, the trial judge stated (§809 for 1988; §1420 for 1989; §1699 for 1990):

> *"To try to assess the exact quantum of any LLP that might have been required for 1988 is neither achievable nor necessary. This litigation is not about what should have been the precise content of Castor's financial statements for 1988. It is about whether or not C&L's 1988 audited financial statements of Castor presented fairly the financial position of Castor in accordance with GAAP, as they purported to do."*

This is simply not GAAP. GAAP requires a specific number and a level of materiality. If the evidence did not permit the trial judge to determine even an approximate quantum of the required LLPs or a materiality level, it cannot permit the determination whether there was a material GAAP departure.

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426 Vance, May 26, 2008, p. 121; Froese, PW-2941-3, vol. 1, p. 34-36 and Jan. 8, 2009, pp. 102-04.

378. This error is compounded in three ways. First, the trial judge made specific errors with respect to specific items on which she found that the misstatement was "huge" or "material", without ever defining that term. It is therefore impossible to assess the impact of such errors on the individual conclusions.

379. Second, by failing to quantify the shortfalls on each loan, the trial judge avoided the GAAP requirement to assess whether an overall LLP was needed. Castor was entitled under GAAP to offset loan security deficiencies against loan security surpluses within each of the borrower groups, and the failure to identify amounts for these makes the calculation of an overall position impossible. Financial statements state a single number for the total value of the loan portfolio (i.e. they do not provide detailed information as to which loans require losses, nor is this an alleged error), so this failure makes it impossible to determine whether the financial statements met GAAP. C&L only issued one opinion on the financial statements as a whole, not separate opinions on individual transactions (§801).

380. Third, the trial judge's failure to identify even an approximate number to be taken to the financial statements disregards the issue of reliance. Widdrington never adduced any evidence as to how large an adjustment to the loan portfolio value would have caused him to change any of his investment decisions. The trial judge's finding that a "huge" adjustment was required for some loans is so subjectively expressed as to be meaningless. How can any other Castor plaintiff prove, or Defendants refute, the proposition that they would not have invested had the line item entitled "investments in mortgages, advances..." been adjusted by a "huge" amount, when nobody knows what that means?

381. The same holds for all other instances where the judgment is excessively general. For example, each investor may react differently to the disclosure of additional RPTs. Some were already noted in Castor's financial statements, and this clearly did not deter any of the plaintiffs from investing. As the trial judge does not identify which transactions ought to have been disclosed as RPTs, the burden of proof has not been met and cannot be met by any other Castor plaintiff.

(ii) Relevant authorities re real estate loans

382. The Handbook (s. 1000.49) lists the authoritative sources that supplement the Handbook, either to define GAAP or to assist accountants in applying GAAP to specific circumstances. The accountant would have recourse to industry-based textbooks and materials (§2130 and Handbook s. 5140). Failure to refer to these sources or to other lenders' approach at the time (including the judgment on objection #71, *infra*, para. 561) prevented the trial judge from understanding how GAAP would be applied by accountants valuing real estate loans.

383. The trial judge's conclusions that the appraisals on the properties that stood as security for Castor's loans were overstated because the required renovations that would allow the value to be achieved were not yet completed (and the properties therefore had not achieved the appraisers' income projections), are not GAAP conclusions. As Froese testified and as Rosen published in his text book, appraised property values consider the property's future outlook and an accountant would not expect the appraiser to consider historical results only.[427] Rosen further conceded in his cross-examination that GAAP's concept of "estimated net realizable value" includes the benefits of future ownership of the asset, and the lender's intentions as to how to access that benefit.[428] The appraisal textbook in evidence indicates that the appraiser must use the "highest and best use" which is defined as "*That use which is likely to produce the greatest net return over a period of time*".[429] Rather than accepting this, the trial judge referred to US guidance regarding auditors' use of appraisals (§2464). As a result, the trial judge's conclusions as to the appropriate value of MLV, OSH, CSH and TSH in all years, which was predicated on her view that the appraisals were unrealistic because actual results had not yet met the levels set out in the appraisals, were reached by applying a standard that is not Canadian GAAP.[430]

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427 Froese, Dec. 9, 2008, p. 191, Dec. 11, 2008, pp. 84-86 and D-739-3; Rosen, D-1095G pp. 67-90 (Chapter 4) of "Understanding Accounting", pp. 73 and 76-77.

428 Rosen, Apr. 7, 2009, pp. 61-65, in reference to PW-3034 pp. 14-17; D-1277-1 p. 4.

429 D-740-2.

430 See §§453, 908, 1140, 1577, 1587, 2467, 2510, 2722.

384. In addition, there are repeated criticisms that Castor's borrowers did not provide financial statements and that without them, necessary information was missing.[431] The trial judge failed to consider Rosen's textbooks[432] which state that banks do not use financial statements to value borrowers' real estate assets and that lenders on mortgages or debt that may be converted into equity normally do not ask for them. If banks and lenders did not regularly seek this information, then clearly GAAP did not require it.

(iii) Specific Errors on the Individual LLPs (1988)

385. The trial judge referred to the LLP ranges set out in Plaintiff's experts' written reports (§§823-26), without considering their testimony in which they conceded that other results would also have been reasonable, thus broadening or lowering their ranges of acceptable LLPs.

386. For example:

a) Rosen testified that he had changed his opinion since writing his report on the individual LLP amounts; did not present his analysis in chief; and in cross-examination stated that he could not explain his calculations.[433] As a result, any reliance on his report is reliance on illegal evidence; and

b) Froese's report, although amended, did not include all changes he made in testimony, such that the trial judge's illegal reliance on written reports rather than testimony led to significant error, as shown below (eg. re YH 1988 and DTS 1990).

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[431] Eg. §2615 re OSH in 1990; §2736 re MEC, §2743 re TWTC, §2749 re Meadowlark, §2752 re DTS, §2953 re YH.

[432] D-1260-5 and D-1263-1 which were used by accounting professors across Canada (Rosen, Feb. 26, 2009, p. 28).

[433] Rosen, Feb. 19, 2009, pp. 232-45, Apr. 8, 2009; pp. 35-37, Apr. 7, 2009, pp. 143–51, 212-19.

387. The actual amount of additional LLPs that the trial judge quantified as necessary in 1988 was $58 million, being $40 million on MLV (§915) plus $18 million on TSH (§1141). She determined that no LLP was required for MEC (§1077), TWTC (§1291) and Meadowlark (§1327). With respect to YH (§1042), CSH (§1193) and OSH (§1222) she determined that a "material" or "huge" LLP was required, without quantifying an amount.

a. MLV

388. The errors mentioned above regarding the trial judge's assessment of appraisals on a non-GAAP basis and accepting Prychidny's hindsight testimony rather than accepting what he wrote in the contemporaneous YHHL documents would, if corrected, reduce the trial judge's conclusions by $21-30.5 million.[434]

389. There were two sources of recovery available to Castor with respect to MLV which the trial judge considered and rejected without performing an appropriate legal analysis of the contracts (§911). One is a "put" which allowed the MLV investors to force Stolzenberg and Karsten von Wersebe ("von Wersebe") to take over their positions at any time.[435] The other is pledges signed by Gambazzi,[436] by which amounts on deposit with Castor were given as security for these loans.

390. The trial judge gave as a reason for rejecting these that they did not provide security against the lowest ranking loans (§§912-13). It is uncontested that both sources of security refer to the loans to the debenture-holders, and do not refer to the loans to the YH companies (KVWIL, YHLP and MLVII). The trial judge's loan and security listings indicate that, at most, these lower-ranking loans totaled $24.3 million (§§863-66). This

434 Based on §906 where Froese and Vance's asset values are compared to Goodman's. As implied in §907, Rosen used the same value from the appraisal on the hotel component as did Goodman.

435 PW-2760, bates pp. 1671-73 is an example. These were still 'in play' as late as 1990, as seen in D-213 point 4a, PW-1187B point 3 and D-659-1 (re: 4.1.15)A.

436 D-576, D-577, D-578, D-580; PW-2177; PW-2760, bates pp. 1679-82; PW-2757, bates pp. 1597-1600, 1555-66; PW-2756, bates pp. 396-99.

means that there is no reason given for failing to apply this security to the $15.7 million of additional shortfall determined by the trial judge. As for the $24.3 million, there is nothing on the face of the agreements that required Castor to exercise its mortgage claim first. Castor could have exercised its rights that were secured by the put and the pledges first (in 1988, 1989 and 1990, the Gambazzi deposits exceeded the other known Gambazzi debts by at least $70 million).[437] In 1988, where there was $130.8 million of debt (the $24.3 million plus the $106.5 listed in §899), this would leave $59.8 million to be covered by the property value, which the trial judge assessed at $100 million (§910).

391. The other reason given to ignore these sources of recovery is the finding that Castor would not have exercised any recourse against Stolzenberg or von Wersebe (§§902 and 914). There is no evidence to support this conclusion. If it is true, it simply demonstrates that Castor's board was prepared to abdicate its duties, and do the opposite of what an auditor was entitled to assume (i.e. act in good faith). A plain reading of the "put" demonstrates, moreover, that Castor's intent was irrelevant. The conclusion regarding Castor's intention is not relevant to the Gambazzi pledges.

392. Finally, the trial judge's conclusion on the required LLP for MLV in 1988 was influenced in an unquantifiable way by what Castor did in 1990 (§911). This is again an error of hindsight.

b. TSH

393. The trial judge concluded that these loans should have carried an LLP of $18 million. The full amount of this provision would be booked against the Lambert loans (§1136).

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437 D-1336 and PW-1053-91, pp. 244-47; for 1989: PW-1053-89, pp. 258-60; for 1990: PW-1053-87, pp. 140-42.

394. GAAP provides that a loss must be probable, rather than merely possible, before a provision can be taken.[438] As a result, in circumstances where Plaintiff has not provided any evidence on a debtor's ability to pay, then his burden of proof to demonstrate the need for an LLP has not been met. No evidence of Lambert's financial position was adduced by the Plaintiff, despite the fact that relevant documents existed.[439]

395. In any event, there is no dispute that the hotel assets were sufficient to cover the loans to Topven (1988) and Topven Holdings, with sufficient surplus to provide value to Lambert to repay a portion of its loans to Castor. The trial judge found that Lambert had no other source from which to repay the balance owing, based solely on evidence relating to 1985-1986 events, including C&L's 1986 working papers (§§1090-1101). There is no evidence to support the assumption that Lambert's assets in 1988 were the same as they were in 1986, particularly when the audit for 1987 noted that the 1986 issue had been cleared,[440] and a reorganization had occurred in 1988 (§1109).

396. In addition, the trial judge's conclusion on Lambert is based on hindsight with respect to 1988 (§1123): no cash circles were found for the 1988 interest payments.[441]

397. But for these reviewable errors, the trial judge would have concluded that the Plaintiff did not meet his burden to prove that a LLP was required on the Lambert loans in 1988.

c. *YH values*

398. All the remaining loans considered by the trial judge for 1988 are loans made to various entities within the YH group, some of which were held to have required a "huge" LLP. This ignored the KvW guarantees. There were other value errors as well.

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438 Froese, Dec. 5, 2008, pp. 13-18; Vance, May 26, 2008, pp. 121-23; PW-1419-2, s. 3020.12.
439 Gaston Baudet, Apr. 29, 1999, vol. 2 pp. 41-42; PW-1195, p. 3 "Covenants".
440 PW-1053-93, sequential p. 35
441 Vance, June 13, 2008, pp. 152-58; Froese, Jan. 27, 2009, pp. 66-68.

I. *Karsten von Wersebe Guarantees*

399. Castor held personal guarantees of von Wersebe, the ultimate owner of the YH Group, in all three years. In 1988 and 1989, these were limited in amount ($27.5 million and $37.5 million respectively).[442] The trial judge misconstrued the guarantees when she ruled that they were restricted to von Wersebe's North American assets (i.e. his holdings in the YH group) and therefore must be ignored (§§989, 1800 and 1802). In addition, she applied hindsight in determining whether this restriction even existed in 1988.

400. The trial judge referred to negotiations between von Wersebe and Stolzenberg (§989). Defendants refer to the actual wording of the final agreements.[443] If any of von Wersebe's European companies had assets in North America, then his interests in those companies would also be caught by the guarantee. This is also how a reasonable accountant would interpret the restriction.[444]

401. As a result of this error, the trial judge failed to consider the evidence that von Wersebe's European companies in fact held assets in North America.[445] She therefore rejected evidence of von Wersebe's net worth (cf. *infra*, paras 564-569).

402. Froese testified that in 1987, von Wersebe had unencumbered assets of $87 million.[446]

403. Moreover, the agreement by which any restriction was accepted on von Wersebe's guarantee was dated December 29, 1989.[447] The loan agreements called for these

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442 For 1988: §987 and PW-1054-10-1 tab 14; PW-1058-1; PW-1053-23, p. 272 (E-187). For 1989 the guarantee on one of the loans was increased: PW-1058-6A tab 12, PW-1053-19, p. 281 E-320, and this does not include an additional $6 million increase as represented to C&L by Whiting in PW-1053-19, p. 261 E-302.

443 PW-1058-4 and PW-1054-10-1, tab 14 (definition g).

444 Froese, Jan. 12, 2009, pp. 66-68; Vance, July 7, 2008, pp. 212-21

445 R.B. Smith, May 14, 2008, pp. 59-62, 212-13, Sept. 16, 2008, pp. 41-43, Sept. 22, 2008, pp. 70-71; PW-1160-19A; Whiting, Apr. 27, 2000, question 75, Apr. 10, 2000, questions 105-107, Nov. 16, 1999, question 91, pp. 108-12; later confirmed by PW-1058-4A; D-846, D-846T, D-848, D-1351 and D-1353, subject to objection (cf. *infra*, para. 564-569).

446 Jan. 12, 2009, pp. 35-40, D-213.

guarantees to be unconditional (§§942, 961). The confirmation replies received by C&L for 1988 and 1989 show no restrictions. The trial judge described the addition of these restrictions as a "1989 event" (§1480).

404. Applying the restrictions agreed to in 1989 to 1988 was hindsight and a failure to distinguish negotiations from an agreement. The trial judge stated that the finalized documents, signed after Castor completed its 1988 financial statements, were the result of previous discussions and understandings (§1480).

405. Defendants agree that under GAAP the appropriate trigger is the meeting of the minds, which normally occurs prior to the actual signing of the legal documentation. However, the evidence referred to by the trial judge is a letter from YH asking Castor to change the written terms of agreements already signed by von Wersebe. There is no evidence that Castor had agreed to any change prior to the completion of its 1988 financial statements.[448]

406. By misconstruing the scope of the personal guarantees given in 1988-1990, the trial judge undervalued Castor's security.

ii. Other YH Group Value Errors

407. Read-in error. The trial judge referred to Froese's report but failed to refer to its amendment in PW-2941-1, following cross-examination (§826). The low end LLP should therefore be reduced by $6.1 million.

[447] PW-1058-4A.

[448] The analysis in §§1480 is irreconcilable with §§1815-1823 where 9 additional guarantees signed by von Wersebe in respect of the Nasty Nine loans issued in 1990 are disregarded because Castor and YH were in negotiations, but the guarantees were not yet signed by February 15, 1991. This is not the correct test, either in GAAP, in law, nor the test used in respect of 1988. The Nasty Nine loans were disbursed in 1990 (§1807) and the discussions on the guarantees were at least as advanced in February 1991 as were the negotiations on the restrictions to the guarantees in February 1989 (see Leonard Alksnis, Feb. 7, 2006, pp. 182, 196, 197 and Feb. 8, 2006, pp. 54-57, 64-66, 71-73, 79-84, 139-42, 150; Whiting, Feb. 24, 2000, pp. 101-25, 130-41, 148-68).

408. Hazelton security. The trial judge concluded that Castor held no security interest in Hazelton Lanes, relying on PW-1059-4 (§965). This does not address the issue as to whether Castor's loan of $29 million (§979) was secured. Castor had a security interest in the entity that owned YH's interest in Hazelton Lanes, and therefore this loan, while not a mortgage loan, was secured.[449] The trial judge erred by failing to treat it as such. Moreover, the trial judge failed to consider R. B. Smith's testimony that PW-1059-4 was a false document, and that Castor was secured[450] and ignored Froese's opinion that Castor's loan was secured by the project.[451] The trial judge relied on Vance, whose recommended LLP was $25.3 million.[452]

409. CFAG. The trial judge found that the sole debtor on the $20 million CFAG loans was YH, "notwithstanding" loan agreements and confirmations (§§979, 1013). It is a reviewable error to disregard such documents and an error of GAAP to imply that a preparer of financial statements could do likewise. Froese testified[453] that his LLP should be adjusted to account for the evidence (which included these documents).[454] The value of this error ranges from $10-$21.8 million.[455]

410. Hindsight. The trial judge relied on hindsight (or accepted the views of experts who did so) by using various YH financial statements which were either prepared after Castor completed its 1988 financial statements or without evidence that they were in Castor's possession: "*YHDL never provided financial statements during the relevant years*" (§1270). Hindsight also influenced her view of the TWTC project, as she referred to 1990 facts in her 1988 analysis (§1292).

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449 PW-1059-1; PW-1059-2, particularly p. 6; PW-1059-3, particularly p. 3 deal #11; PW-1059-4; PW-1059-5 and PW-1059-5-1; PW-1059-6; PW-1059-6A, Tab 20.

450 R. B. Smith, Sept. 18, 2008, pp. 101-14.

451 PW-2941-3, vol. 4, para. 2.265.

452 §999 and footnote (Vance, Apr. 14, 2008, p. 141).

453 Froese, Jan. 9, 2009, pp. 183-214, Jan. 12, 2009, pp. 24-27 and Jan. 27, 2009, pp. 120-23; PW-1177-1, PW-1178, PW-1179, PW-1180, PW-1181, D-1080; Whiting, Feb. 8, 2000, pp. 110-14, Feb. 15, 2000, pp. 141-47, Nov. 17, 1999, pp. 176-91.

454 There is no evidence of Investamar (the other debtor)'s inability to repay.

455 Vance's LLP was $11.1 million (PW-2908 vol. 3 p. 9 #7), Froese's was $21.8 million (PW-2941-1) and Rosen's was $10 million (PW-3033 vol. 2, s. C p. 51).

411. The first three errors noted above, if corrected, would reduce the 'huge' but unquantified LLP found by the trial judge to be necessary on YH Group loans by $41.4 to $53.2 million. The hindsight error vitiates the conclusion completely, as all three Plaintiff's experts' analyses are completely dependent on their use of hindsight financial statements.[456]

d. Cross-Collateralization

412. The trial judge rejected the evidence that Castor was entitled under GAAP to offset any security deficiencies against security surpluses that existed with respect to the same borrower or borrowing group. That rejection is inconsistent with various findings of fact, admissions made by the Plaintiff and testimony given by Plaintiff's experts, as set out below. Had this GAAP principle been applied, no LLP would have been required.

413. The judgment concludes that such set-off was impermissible under GAAP because Castor did not have legal contracts with its borrowers entitling it to do so, and that Castor did not intend to do so (§§1018 ff.).[457] This would be true if Defendants' position was that Castor's right to offset created a security interest. That is not the position. Instead, it is simply this: under GAAP as generally applied by lenders at the time, where a debtor grants security in respect of a specific real estate holding, although the creditor will look first to the security to recover the debt, should the security be insufficient, the lender is entitled to recover the debt against all the debtor's patrimony, as long as prior-ranking rights, if any, are recognized, as will be shown below.

414. The trial judge characterized cross-collateralization within the YH Group as "Goodman's theory", and stated that Froese and Vance opined that it was not GAAP (§§1016-29). The cross-examination of these two experts demonstrates that such re-

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456 Froese: §§1002-1004 and footnotes 410 and 411 above; Vance constructed his LLP computations (PW-2908 vol. 3 p. 8) using PW-1137-2, dated March 10, 1989; Rosen could not identify his source documents (Apr. 8, 2009, pp. 35-37). For 1988 he admittedly had none (PW-3033 vol. 2 p. C-51).

457 The relevant paragraphs are taken from Plaintiff's written argument of July 8, 2010, pp. 97-98.

allocations and cross-collateralization were normal in the lending industry and would normally be considered when accounting for loans.[458] Vance explained the practice as follows:[459]

> *"Well, with a construction company, and that's the way, certainly in my experience, it's always been practised, even though they're put in individual entities in case that one project gets in trouble, you consolidate them all and they're all used as one entity, and that is actually the way they were reflected in the consolidated financial statements of the D.T. Smith Group."*

Froese testified that he agreed with Goodman's approach on offset under GAAP, even though his report might not be that clear. He testified that this opinion was expressed in the report if one reads the report thoroughly.[460]

415. Castor's intent can only be inferred from its documented conduct, as the Plaintiff called no witness who had actual knowledge. Stolzenberg and Dragonas would have known, according to R. B. Smith, who was not invited to the negotiations between YH and Castor that Dragonas organized, and knew less than Stolzenberg did about von Wersebe's finances.[461] The evidence demonstrates that every year there was re-allocation of accrued interest within the YH Group. These reallocations took place shortly after year end, when the parties knew what debts had grown and what projects had increased in value, and the new loans and any security or guarantees were arranged.[462]

416. The next issue is the identification of what is in the "YH group". As the experts testified, GAAP looks to the parties' intentions and to the substance of their relationship rather

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458 Vance, Apr. 21, 2008, pp. 13-17, PW-1480, Apr. 10, 2008, pp. 150-51; Froese, Jan. 12, 2009, pp. 148-53 as corrected, Jan. 9, 2009, pp. 40-59 and 121-122. Vance testified (July 7, 2008, pp. 161-65) that any error in MEC, TWTC and YH would affect his computations in respect of the others.

459 Vance, Apr. 21, 2008, p. 15.

460 Froese, Dec. 2, 2008, p. 108, Jan. 12, 2009, pp.148-53 and Nov. 28, 2008, pp. 197-98.

461 R.B. Smith, Sept. 17, 2008, pp. 16-7, 20-1, 113-4.

462 B MacKay, Aug. 24, 2009, p. 179-188, R. B. Smith, May 14, 2008, pp. 157-61.

than their legal form.[463] As Plaintiff's ordinary witnesses testified, Castor and YH treated YH as a single borrowing group,[464] and DTS and Castor did the same regarding DTS.

417. Despite the general statements pursuant to which the trial judge rejected this "offset" or "cross-collateralization" principle, she in fact made numerous findings of fact that are consistent with it and inconsistent with her rejection of it. It is uncontested that the debtors on the YH Corporate loans, OSH in 1988-89, some of the MLV loans, some of the MEC loans and some of the TWTC loans were all YH companies. Moreover, many of the trial judge's findings explicitly refer to such offsetting, reallocation or cross-collateralization actually occurring at Castor within various companies that were not owned 100% by YH[465] (eg. §§49, 442). All the 1988 loans referred to in these paragraphs are included in the YH Group. TWTC is also identified as a YH company in §§916-19.

418. Moreover, the trial judge's rejection of cross-collateralization ignores admissions made in Widdrington's written pleadings and by his witnesses about what loans were included in the YH Group and that it was a single borrowing group within which cross-collateralization would apply.[466]

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463 PW-1419-2 s. 1000.18a; Vance, March 10, 2008, pp. 168-70.

464 Mackay, Aug. 24, 2009, pp. 83-87 and Aug. 26, 2009, p. 99; RBS May 14, 2008, pp. 57-72 and 136-161; PW-1157 prepared by Whiting.

465 Eg. §§929 and 2671 outline the mechanics of the account Castor used to re-allocate interest among loans and borrowers. §§974-977, 1486-87 and 1492 set out other year-end "circles", all of which show the same pattern. §880 cites Prychidny to the effect that YH was "the absentee owner" of MLV. Although the trial judge concluded that deficiencies in respect of the TSH could not be dealt with by way of set-off, she did so on the basis of evidence she described as "equivocal" (§§1138-1139), demonstrating that Plaintiff had not met his burden of proof. See also §§192-3, 937, 1062 and 2702 .

466 Widdrington's Re-re-amended Declaration with Particulars, para. 89 (and PW-33 p. 1), 109, 111, 114 (and PW-33a) and 120b. Gourdeau presented PW-2893-20 showing YH Group Loans, which includes the MLV Investor loans, the loans to the three Skyline Hotels and the loans to 97872 and 612044 (the non-YH part of MEC). He explained this chart as grouping all the loans that he considered part of the YH Group (Jan. 17, 2008, pp. 31-36) and confirmed (Feb. 20, 2008, pp. 22-33) that despite his knowledge that 612044, 97872 and the MLV Investors were not necessarily owned by YH, he grouped them as YH loans for purposes of

419. This matters. At least one source of available surplus in YH was MEC. Froese had concluded in his 1997 report that a surplus of $20-40 million existed in 1988[467] and testified that a reasonable accountant would consider it in his YH LLP calculations.

420. The trial judge concluded that Castor had no intention of exercising its rights under the MEC agreements, without reference to any evidence in support[468] (§§1034-35; repeated in §1906 for 1990). There is no evidence, and the hypothecs establish Castor's rights.[469] The fact that Castor did not exercise its security at any time prior to February 28, 1989 or even February 15, 1991 does not mean it would not have done so had it perceived the need. The trial judge considered what happened after the relevant date in each year, which is hindsight.

421. The trial judge held that Castor had no contracts which allowed it to use excess value in one of YH's assets to make up for a deficiency in another (§§1039-40), ignoring her own finding that as early as 1986, YHDL signed a loan document which stated: "*To provide a blanket Fixed and Floating Charge Debenture financing on the assets of the Borrower for the purpose of bridge financing the sale and refinancing of the various assets of the Borrower*" (§939). This same language existed upon renewal in December 1987 and continued to exist thereafter.[470] The plain meaning of the contract supports Defendants' position, and the trial judge's finding that Castor did not have a legal right to cross-collateralize (§1040) is an error of law.

422. The YH surplus values reduce any LLP. As the trial judge failed to quantify the LLP required for YH, CSH or OSH, it is impossible to determine the remaining impact of the error of overlooking the surplus.

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determining the loan deficiency. He testified that **any loan security surplus within this group could be applied against a deficiency in the group** (Feb. 22, 2008, pp. 93-96), PW-2893-19, PW-2893-20, PW-2893-25, PW-2893-64. Cross-collaterization at D.T. Smith: R.B. Smith, June 10, 2008, pp. 57-58, Sept. 24, 2008, pp. 88-89; Froese, Nov. 28, 2008, pp. 197-98.

467 Froese, Jan. 9, 2009, pp. 48-52, D-1079 (see §1074).

468 This conclusion is essentially taken from Plaintiff's argument of July 8, 2010, p. 100.

469 PW-1063-5B clause 17; PW-1063-5B-2 clause 17; PW-1102A-4-1 clause 29; PW-1102B-2 clause 4.6; PW-1102B-5 clause 4.6.

470 PW-1054-1, PW-1054-3, PW-1054-10, PW-1054-14 and PW-1054-15.

(iv) Conclusion on Value of Loan Portfolio, 1988

423. The above errors demonstrate that the trial judge erred in concluding that a LLP of $58 million plus a further unquantified 'huge' amount was required to be booked by Castor in 1988. The errors are demonstrably large enough to more than eradicate the $58 million of identified LLP. It is not possible for the Defendants or this Honourable Court to determine by what amount the 'huge' remaining LLP would be reduced and whether, after reduction, the required LLP, if any, would be 'material', as this term was also not quantified in the judgment.

(b) Disclosure Items – 1988

424. In addition to the value of the loan portfolio, the trial judge found misstatements in the disclosures in Castor's financial statements regarding: i) the failure to disclose the amount of capitalized interest; ii) RPTs; iii) Notes 2-4 (maturity matching); iv) the $100 million debenture; v) restricted cash; and vi) fee diversion.

(i) Amount of capitalized interest

425. The trial judge erroneously selected among competing schools of thought in determining that there was a requirement to disclose what portion of Castor's revenue consisted of capitalized interest, either as a result of a specific Handbook requirement (including the holding that GAAP required a Statement of Changes in Financial Position ("SCFP")) or an overriding concept of "fairness".

426. Froese testified that the Handbook did not contain a specific requirement to disclose capitalized interest revenue policies or amounts.[471] Froese stated that given the extent to which capitalization was occurring at Castor, Castor and C&L should have given consideration to some form of disclosure. He explained he was not giving an opinion as

[471] D-1071; Froese, Dec. 4, 2008, pp. 92-98.

to what the results would be. In any event, if GAAP does not require it, no amount of 'consideration' by the auditor can oblige the client to make the disclosure.[472]

427. With respect to whether s. 1540 Handbook required a SCFP which would have, if properly prepared, made such disclosure (as the trial judge concluded in §§1333, 1643, 2163 and 2172), this does not reflect the Handbook, the practice or the authoritative literature of the day, nor was it required by Castor's incorporating statute.[473] As Vance conceded, there was no clear authority for a lender to segregate capitalized interest revenue until June 1991.[474] Moreover, the trial judge recognized that given the wording of the engagement letter and the audit opinion which explicitly referred to a Statement of Changes in Net Invested Assets, no reader could have been misled as to what C&L opined on (§§2160-62).[475]

428. The trial judge held that an overriding principle of "fairness" imposed a disclosure requirement not otherwise found in GAAP (§792),[476] despite the evidence[477] that there was no appeal to a "higher" authority than GAAP as recognized by the Handbook and

472 Vance, D-964, May 12, 2008, pp. 153-54, May 26, 2008, pp. 148-51, May 28, 2008, pp. 249-50, May 4, 2010, pp. 137-38; Rosen, D-1260, esp. pp. 192, 193; D-1263, esp. pp. 145-47, Feb. 26, 2009, pp. 28-37; D-1263-2.

473 Rosen, March 30, 2009, pp. 154-55; D-1258-1, p. 609; D-1258-2, p. 640; Vance, May 27, 2008, pp. 202-04, PW-1419-2A s. 5000.4. §531 refers to Vance's opinion that a 1985 Handbook amendment ended the debate in the profession described by a recognized authority, Anderson (PW-1421-7), without reference to: Rosen's post-1985 publications: D-1260-4 pp. 167, 169, 546, 549-50, D-1278, D-1279 and D-1299, uncontradicted evidence of what other lenders were providing in 1988-1991 (D-1295-2 (Exhibit 1) a 1989 letter from OSFI stating that the Handbook provision was insufficient for purposes of cashflow information (D-742); and CICA post-1985 publications (PW-1419-12, D-659-1 (4.5.8.17) esp. Introduction which show that non-uniformity prevailed until at least June 1991).

474 Guideline on SCFP for Financial Institutions PW-1419-12; May 27, 2008, pp. 185-93.

475 Plaintiff's expert Lowenstein testified that he found the SCNIA to be "unusual but most useful" on March 21, 2005, pp. 38-39.

476 This paragraph is taken from Plaintiff's written argument of July 8, 2010 (p. 102).

477 Vance, March 4, 2008, p. 88, Apr. 17, 2008, pp. 67-68, May 28, 2008, pp. 199-200; §768; Rosen, D-1260 pp. 191-93; D-1263 pp. 146-47; D-1098, Feb. 25, 2009, pp. 125-28; CICA, Handbook (PW-1419-1A; Pw-1419-2A) s. 5400.11 and 5400.12, Handbook (PW-1419-3A) s. 5400.15-5400.16, D-520, esp. p. 3, D-659-1(4.4.08)A and B; Anderson PW-1421-9 and PW-1421-22; D-1259, esp. p. 49.

that the word "fairly" in the audit opinion is a warning that the auditor gives <u>less</u> than absolute assurance.

429. The very manner in which the trial judge articulated the question on 'fairness' in §715 reveals that she was not applying GAAP, as she identified it as a <u>third</u> source of the requirement to disclose capitalized interest, independent of the Handbook or general practice.

430. During trial,[478] the trial judge noted that the date of the *Kripps* judgment (1997) is not material <u>if</u> the judgment reflects what everyone knew to be the prevailing standards in 1988-1990. Despite this acknowledgment, the trial judge relied on *Kripps*, thereby importing hindsight. The affidavit of the CICA President Mr. Rayner,[479] in support of an application to seek intervenor status in *Kripps* at the Supreme Court of Canada, indicates that the CICA did not agree with the British Columbia Court of Appeal. Therefore, an accountant in 1988-1990 could not have known that the BC Court of Appeal would decide in 1997 that there was a principle of 'fairness' that auditors should apply. Nor would he conclude, even after the 1997 judgment, that this ruling applied to financial statements governed by a statute (the Act) that differed from the BC statute (which was unique in calling for an additional opinion on fairness, separate from "fair in accordance with GAAP").[480]

431. Anderson's recognized textbook (§2337) states that the *B.C. Corporations Act* was unique in that it required a 'two-part' opinion from auditors.[481] The company in *Kripps* was subject to that statute.[482] Until 1976, that had been the Handbook standard as well: the opinion stated that the financial statements were presented fairly <u>and</u> were in accordance with GAAP. However, the change in 1976 meant that auditors thereafter

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478 Vance, Apr. 12, 2010, pp. 110-115.
479 PW-2370-5A-C.
480 PW-1421-22, esp. p. 553, footnote 18.
481 PW-1421-22, p. 553, footnote 18.
482 PW-2370-3 p. 32, starting at line 22.

provided only one opinion (§§754, 755). The trial judge did not appreciate the significance of this and held C&L to a standard that did not apply.

432. The trial judge's reliance on *Kripps* is further misplaced, as she referred to paragraph 66 of the *Kripps* judgment which starts with the words "Given the aim of auditing..." (§798). To understand the BCCA majority view, it is necessary to consider paragraph 64 which described the "aim of auditing" as:

> *"It is my view that the aim of an auditor's report is to allow auditors to provide their professional opinion which may be relied upon as a guide to business planning and investment. (...)"*

Whether or not that statement was accurate for a company incorporated under B.C. companies legislation (as it then existed) and subject to broad disclosure requirements under securities legislation (as was the company in *Kripps*), it is not accurate with respect to a statutory audit of a private company such as Castor, as expressly found by the Supreme Court of Canada in *Hercules*. *Kripps* was released one month prior to *Hercules*. The decision in *Hercules* must either be seen as overturning the underlying rationale of *Kripps*, or at least limiting *Kripps* to companies governed by the BC legislation.

433. In addition to the question as to whether there was a requirement to disclose capitalized interest revenue, some passages of the judgment indicate that the trial judge erroneously concluded that there was something wrong with treating the capitalized interest revenue as revenue on Castor's financial statements (§734). In fact, as the trial judge correctly noted, "... *where a loan agreement provides for planned capitalization of interest and/or fees, the accrued interest and fees are recognized as revenue provided that there is reasonable assurance of collectability.*" (§765). This is also true of 'unplanned' capitalization (i.e. the only issue is one of ultimate collectibility), as the evidence shows.[483] In other words, where the interest that had been accrued

483 None of Plaintiff's experts distinguished between the original loan disbursement and the capitalized interest component in their LLP computations (PW-2941-3, vols 2-5; PW-2908, vol. III; PW-3033, vol. II); Vance, May 28, 2008, pp. 96-101.

during the year was added to the loan balances upon renewal at year end, the correct question under accrual accounting is whether there is a probability that the resulting total loan balance will not ultimately be fully collectible. If there is such a probable loss, an LLP is taken. There is no additional question.[484]

434. The trial judge stated (§2156):[485]

> *"Appropriate disclosure would have had a significant negative impact on the income, revenue and profit recorded by Castor. Capitalized interest increased profitability but did not improve cash liquidity. «In effect, the earnings statement of Castor was showing success when the opposite was the case.»"*

This highlights the trial judge's fundamental misunderstanding of accrual accounting. An earnings statement under GAAP does not purport to show liquidity, as what is 'earned' is not necessarily what is 'paid'. Under accrual accounting, an amount is earned when due and it would have been contrary to GAAP for Castor to have accounted for its interest income on a cash basis.[486]

435. The distinction drawn by the trial judge between planned and unplanned capitalization is a red herring, once it is recognized that no disclosure was required. Moreover, a review of the judgment reveals that the conclusion that 'huge' amounts were unplanned is not supported by the evidence.[487] This in turn led the trial judge to the erroneous conclusion (eg. §§2155 and 2158) that there was a failure or inability of Castor's borrowers to pay which should have been alarming. These errors then led the trial judge to reach a series of conclusions about Castor's business which are not supported by the evidence (§§56-62).[488]

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484 Rosen, D-1258-1 p. 246 "*GAAP for revenue recognition is wide open*"; D-1260-3 pp. 255-56 point #2 and p. 299.

485 Taken from Plaintiff's written argument of July 8, 2010, p. 103.

486 Vance, May 4, 2010, pp. 154-55; Meigs, PW-3108-1 p. 90 and PW-3108-2 pp. 541-542.

487 The conclusions at §§734 and 2478 are contradicted by §733 (and its footnotes) which identify the evidence of planned capitalization for MEC, Calgary Skyview, the Skylines, MLV and TWTC and §1987 which indicates planned capitalization for DTS.

488 These paragraphs are taken from Plaintiff's written argument of July 8, 2010, pp. 3-4.

(ii) RPTs

436. The trial judge determined that the financial statements were misstated in that there were unreported RPTs. However, she failed to apply GAAP for RPTs as explained by Plaintiff's experts, who testified that the following principles were relevant:

a) there is no GAAP requirement to list all related parties. The requirement is to disclose RPTs. The key element that must exist is one of control over the operating and financial decisions of both companies regarding the transaction between the reporting entity and the other party;[489]

b) a common director does not automatically create related party status between the two companies he serves.[490] It is necessary to consider his actual role and degree of influence with respect to both contracting parties;[491]

c) where the individual common to both companies is acting as a nominee for others, the Handbook in paragraph 3840.07 requires that the identity of beneficial owners be considered, if known;[492]

d) merely signing a confirmation reply is insufficient evidence under GAAP or GAAS on which to base a conclusion about whether a RPT exists.[493]

437. Plaintiff did not meet his burden of proof, as he failed to bring evidence to show that the individual providing the 'link' between Castor and its co-contractant had the requisite degree of *de facto* control or influence over both companies with respect to the transactions that the trial judge identified as undisclosed RPTs. The judgment is insufficiently clear to allow Defendants or this Court (and other Castor plaintiffs) to determine which alleged RPTs were held to be reportable under GAAP, with the

489 PW-1419-2; Handbook s. 3840.01, 3840.03 and Rosen, March 31, 2009, pp. 162-66.
490 Rosen, March 31, 2009, pp. 208-11; Vance, July 8, 2008, pp. 147-49.
491 Vance, June 4, 2008, pp. 43-46.
492 Vance, March 10, 2008, pp. 144-45.
493 Vance, June 4, 2008, pp. 119-28.

exception of four transactions or groups of transactions, 3 of which are relevant to 1988, as follows.

438. MEC. The trial judge concluded that Stolzenberg was the owner of record of 612044 Ontario Ltd. ("612044") and through it, of 97872 Canada Inc. ("97872") (itself a 50% owner of MEC), that Stolzenberg was the incorporator, the President and a director of the 97872 and that 612044 had pledged its shares of 97872 to secure a loan from Castor (§550). The evidence referred to in §551 does not support the conclusion that there was common control or significant influence through Stolzenberg and in fact there is evidence that Stolzenberg was acting in a representative capacity and that lender and borrowers were unrelated.[494]

439. Gambazzi and Bänziger. The trial judge determined that Gambazzi and Bänziger exercised sufficient influence over Castor to be related parties (§§553, 557-58). However, there is no evidence of their actual role with respect to the other parties to the transactions where they acted in a representative capacity.[495] The trial judge's conclusion is based on their signatures on loan documents and audit confirmations (§561), in direct contradiction of the standards identified above.

440. Trinity. The trial judge found that Stolzenberg exercised the requisite influence over Trinity to make it a related party (§552). On that basis, Defendants agree it should have been reported as such under GAAP. However, as Widdrington sat on Trinity's board, he knew or ought to have known what role Stolzenberg played, and therefore could not have been misled by this GAAP omission.[496]

441. Regardless, this is not sufficient to determine that there was a GAAS breach and the judgment is silent as to the applicable GAAS for RPTs. Plaintiff's experts conceded in

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[494] PW-1053-48, p. 159, E-115; R.B. Smith, Sept. 24, 2008, pp. 17-21; D-94 and D-99-C (MEC did not disclose Castor as a related party); Dragonas, not Stolzenberg, one of C&L's contacts for the audits (§92), represented the owners of MEC (§1533).

[495] Rosen, Apr. 6, 2009, pp. 64-65; Vance, June 5, 2008, pp. 179-82.

[496] §§3256 and 3259 illustrate that this did not matter to his decision.

cross-examination that this is one issue on which auditors are particularly reliant on management and that C&L obtained corroborated representations.[497]

442. In all years, C&L required that Castor sign representation letters which expressly stated that all RPTs and all encumbrances had been disclosed.[498] The trial judge found that these letters were "inaccurate" (§2934).

443. The trial judge stated that had C&L performed an appropriate audit, they would have become suspicious (§2935). However, there is no discussion in the judgment of what tests would have been appropriate and would have aroused suspicions.

444. Although the trial judge cited from the Handbook on management representations (§2449), that citation was selective in that it omitted s. 5300.19(b)(iii), which states that management representations are appropriate audit evidence. Further, it omitted a sentence from the middle of s. 5300.26, which says that one internal representation can be corroboration of another,[499] ignored Froese's and Rosen's testimony that a representation letter constitutes audit evidence and Vance's testimony that he had never seen an audit opinion issued without a representation letter in support.[500]

(iii) Notes 2-4

445. The conclusion that Notes 2-4 of the financial statements 'improved' Castor's liquidity (the maturity matching issue), is either inconsistent with the trial judge's own findings or is based on confusion between "maturity" and "liquidity".[501] The appropriate date to select for <u>maturity</u> disclosure "...*on both sides of the balance sheet - assets and*

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497 Froese, Dec. 5 2008, pp. 134-38 and the *Auditing Guideline on Related Party Transactions* PW-1419-2a, which allows an unqualified opinion even if management cannot be certain that all RPTs have been discovered; Froese, Jan. 8, 2009, pp. 109-22; Penny Heselton, Apr. 26, 1996, pp. 119-121; Rosen, D-1284; PW-1053-22, pp. 223-25.

498 eg. for 1989, PW-1053-17, seq. pp. 75-77, PW-1053-72, seq. pp. 60-62, D-58, PW-509.

499 This is the same omission as found in Froese's report, PW-2941-3, vol. 1 para. 7.3.

500 Froese, Dec. 5, 2008, pp. 130-40; Rosen, Feb. 27, 2009, pp. 200-02, Apr. 6, 2009, p. 113; Vance, Apr. 16, 2008, pp. 33-34.

501 D-510-20.

liabilities - had to be the contractual due dates at year-end, not some random dates of expected future payment made after likely rollovers" (§655). Rosen confirmed that this was the GAAP standard.[502] Therefore, the conclusion as to what Castor should or should not have expected in terms of the timing of the repayment of specific loans (§657) has nothing to do with the information its financial statements would convey. The same is true of §662 and §663 which confuse the maturity dates (i.e. those provided by contract) with liquidity (i.e. when the amount will likely in fact be paid, given the business reality of expected renewals upon maturity). The trial judge failed to apply Canadian GAAP as she had correctly articulated it in §655.

(iv) $100 million Debenture

446. The trial judge's conclusion on this 1987 transaction is that as it was a cash circle, the financial statements were misleading (§685).[503] No details are given as to how they were misleading nor what a corrected financial statement would have looked like.

447. Any suggestion that the assets and liabilities would have to be removed from the financial statements (as described in §§681 and 682) is incorrect in law. A circular transaction is not invalid or suspicious: there is a real effect of legal relations that entities enter into and the fact that transactions are implemented by way of "cheque shuffle" does not detract from the fact that in the result, one amount (or loan) is paid (or repaid) and another is contracted, as found by the Supreme Court in *Singleton*.[504]

448. Any suggestion that the maturity matching notes are incorrect is inconsistent with the trial judge's finding at §665, once the impact of *Singleton* is appreciated.

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502 D-1281 s. 55; Rosen, March 31, 2009, pp. 81-84.

503 §§684 and 2179 refer to an admission by Selman. He stated that if circular, this would have been a RPT, which is not what the judge concluded, and that it would have been material if the amount in question was $100 million, which he disputed (Selman, May 21, 2009, pp. 215-218, 228, June 22, 2009, pp. 17-18).

504 *Singleton* v. *Canada*, [2001] 2 S.C.R. 1046. See paras 32, 34 and 43 of Justice Major's judgment. The same error (i.e. equating a circular transaction to a sham that would have no 'true' effect) is made in respect of the Nasty Nine loans in 1990 and the payment of some of Lambert's interest in respect of 1989 and 1990.

449. Moreover, the judgment for all three years is based on hindsight in that it refers to this as a $100 million rather than a $50 million issue. The trial judge's analysis refers to the full $100 million of debentures and loans (to Morocco and Foxfire) (§§667-80). However, the loans in 1988-1990 were to Morocco and Licaon ($50 million each) (§681). The Licaon loan replaced the Foxfire loan, but as Vance conceded in cross-examination, the pledge of the debentures did not follow the loan to Licaon in 1988: Licaon's loan was secured by pledges of deposits until February 18, 1991 when the debentures were pledged as security.[505]

(v) Restricted Cash

450. In all three years, the trial judge found that there was an undisclosed pledge restricting cash that Castor had on deposit with Credit Suisse. In 1988, the cash was deposited by one of Castor's European subsidiaries (§698). In 1989 and 1990, it was deposited by the Irish subsidiary (§§1403, 1407).

451. For 1988, no pledge of the Credit Suisse deposit has ever been produced and its existence is conjecture, based on a theory proposed by Vance as to the meaning of the words "payment obligation". The trial judge accepted Vance's theory that it meant "pledge" (§§689, 705) and the observation that Defendants' expert could not prove him wrong is an instance of the trial judge reversing the burden of proof (§706).

452. In any event, Defendants' view that Vance's theory was mere conjecture was confirmed by a court in Ireland in a judgment rendered in 1997, regarding a dispute between CH Ireland and Credit Suisse on the 1989-1990 pledge. The Irish Court ruled that the words "payment obligation" meant that Credit Suisse Zurich had guaranteed the repayment of the loan by Credit Suisse Canada to Castor,[506] different from a pledge that CH Ireland had signed in Credit Suisse's favour. In fact, §697 indicates that Vance also held this view.

505 Vance, May 27, 2008, pp. 57-60; PW-2168, PW-2169; PW-2070; PW-2171.
506 D-582, p. 3.

453. Therefore, applying the correct burden of proof, no disclosure was required.

454. Moreover, the representation letters[507] stated that there were no undisclosed encumbrances. Contrary to §1414 (regarding the 1989 restriction), either Castor lied in its representations to C&L or it in fact knew the pledge was unenforceable, but both cannot be false, as the trial judge has concluded. The same is true in 1989 and 1990 in respect of the Credit Suisse pledge and in 1990 in respect of another pledge to Bank Gotthard that the trial judge held was not disclosed in 1990 (§1689). If these pledges were in fact (or believed to be) valid, then Castor lied in the representation letters.

(vi) Fee Diversion

455. The only GAAP question relevant to this issue is the 4th question posed by the trial judge: "*Fourth, were the financial statements misstated by the non-inclusion of these fees in income?*" (§2053) The correct GAAP reply is "no", consistent with Vance's position that the diversion had no impact on the income statement (§2087). The trial judge's conclusions (§2113) do not address GAAP. Therefore, the only possible conclusion is that the financial statements were not misstated as a result of this series of transactions.

456. Moreover, the trial judge's GAAS analysis is heavily influenced by hindsight, as Vance was only able to uncover the diversion after: a) being advised of its existence by the Trustee; b) reading David Smith's testimony; and c) performing a forensic analysis over three years. Vance further conceded that he could not have arrived at his conclusion in respect of the 1988 or 1989 transactions without considering 1990.[508]

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507 PW-1053-22, pp. 223-25, PW-1053-17, pp. 75-77, PW-1053-12, pp. 227-29, PW-509, PW-559.
508 Vance as cited in §2081 and June 12, 2008, pp. 95-102.

(c) 1988 Financial Statement Conclusion

457. Once the judgment is corrected for the errors listed above, it is clear that Plaintiff has not met its burden to show that the financial statements did not fairly present Castor's position in accordance with GAAP.

458. As Defendants indicated in argument, the one possible exception to this is the issue of RPT disclosure. On the basis of what is now known, Defendants have some reason for concern that despite conducting a GAAS audit on this point, they were not given an opportunity to consider all the relevant facts. However, even all the evidence available today is insufficient to permit a GAAP conclusion that additional transactions were required to be disclosed as RPTs.

4) 1989

(a) LLPs

459. The same issues arise in 1989 as in 1988. The same loans that were considered in 1988 were reconsidered in 1989 and the trial judge adopted her reasoning from 1988 *mutatis mutandis* (with the same errors regarding analysis of appraisals, use of hindsight and failure to cross-collateralize) (§§1473, 1476, 1518-19, 1568, 1582, 1599). Defendants identify some further errors unique to 1989 below, the first 4 of which total $53.7 to 57.6 million.

460. <u>MEC</u>: The accounting treatment for future interest impacts the computation of security value for MEC in 1988 and 1989 as well as DTS for 1990. The question is whether GAAP required the lender to deduct the interest that the borrower will owe the lender in subsequent years from the value of the security. The trial judge stated that both Froese and Vance included such interest in the costs to complete, but Goodman did not (§§1527, 1529). She ignored Froese's testimony[509] that he agreed with Goodman on

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509 Froese, Dec. 10, 2008, pp. 32-35, Jan. 13, 2009, pp. 106-107

this point as a matter of GAAP and that Canadian accounting rules for lenders in force in 1990 did not require the lender to add potential losses on the future interest receivable to his LLP. She ignored Rosen's testimony that his calculations did not discount for future losses as GAAP did not require it.[510] The amount of future interest deducted from value by Vance and Froese in their reports relied on by the trial judge was: a) MEC 1988 – $0 to $19 million;[511] b) MEC 1989 $8.2 to $11 million;[512] and c) DTS 1990 – $14 to 19 million.[513]

461. Froese's calculations on these projects are inconsistent with his views on GAAP. When confronted with this, he testified that his computation regarding MEC which treats the future interest differently from how he explained GAAP standards, was based on hindsight.[514]

462. MEC. The trial judge adopted Vance's view that the lower of two appraisal values with the same date be used ($261 million) (§1549), despite the fact that Froese, whom she accepts as a reasonable accountant applying reasonable methodology, used the higher appraisal. In fact, Froese used $285 million as compared to Goodman's $275 million from the same appraisal.[515] The trial judge also disregarded another concession made by Froese[516] that would reduce his LLP on MEC in 1989 to a negligible amount.

463. OSH. An error made in 1988 (§§1215 and 1222) is repeated in 1989 (§§1597 and 1599): she relied exclusively on Vance's computations, despite his testimony[517] that his computation was based on his recasting of an appraisal. He admitted that he lacked the necessary competencies, and would not base an LLP on those computations.

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510 Rosen, Feb. 25, 2009, pp. 87-91
511 Froese did not present a LLP computation; Vance, PW-2908 vol. 3 pp. 38, D-99D, bates p. 15.
512 Froese, PW-2941-3 vol. 3, para. 3.9; Vance, PW-2908, vol. 3 p. 40, D-99[E], bates p. 8.
513 Froese, Jan. 13, 2009, pp. 42-59; Vance July 8, 2008, pp. 101-102, D-862.
514 Froese, Jan. 27, 2009, pp. 134-136 and 169 (see §§1527, 2041, 2047).
515 PW-2941-3 vol. 3, para. 3.103 and Froese, Jan. 7, 2009, pp. 203-4.
516 Froese, Jan. 8, 2009, pp. 145-53.
517 Vance, July 7, 2008, pp. 18-27.

Therefore, Plaintiff brought no evidence of the actual GAAP position. This error has a value of $14.5 million (§425).

464. Meadowlark: The only Plaintiff's expert to give an opinion on Meadowlark was Rosen. The trial judge adopted it (§§1628 and 1631; this has a value of $7-8.1 million, §1426) without considering that he admitted that his computation was in error.[518]

465. YH Corporate: If the hindsight financial statements are disregarded, the expert opinions the trial judge relied on no longer have a factual basis.[519]

(b) 1989 Disclosure Issues

466. Restricted Cash. The disclosure issues remain the same in all years. However, in 1989, the 1988 Credit Suisse loan was repaid and a new loan was contracted and placed on deposit in CH Ireland's account at Credit Suisse. That arrangement stayed in place throughout 1990. The trial judge found that this arrangement included a pledge by Castor that was required to be disclosed (§1415), despite the evidence that the Irish court seized with a dispute on the pledge in question ruled that the pledge given by Castor to Credit Suisse in 1989 was unenforceable as a matter of Irish law (§1409). Therefore, disclosure of its existence in the 1989/1990 financial statements would have been misleading.

467. The trial judge totally erred in failing to apply Canadian GAAS and the Act with respect to this transaction in 1989 and 1990.

468. It is uncontested that the Defendants do not include partners of C&L firms other than the Canadian partnership, and that the audits of Castor's Irish subsidiary for 1989 and 1990 were not performed by the Defendants but by C&L Ireland.[520]

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518 Rosen, Apr. 8, 2009, pp. 207-09 and PW-1053-18 p. 117 BB40.

519 Froese: §§1504, 1506 and footnotes 410 and 411 above; Vance constructed his LLP computations (PW-2908 vol. 3, p. 15) using PW-1137-4, dated Feb. 19, 1990; Rosen could not identify his source documents (Rosen, Apr. 8, 2009, pp. 35-37). For 1989 (PW-3033 vol. 2, p. C-44-46), no source documents are provided.

469. The trial judge misunderstood the role of two auditors where one audits a subsidiary and the other audits the parent company. She stated that C&L Canada asked C&L Ireland to perform certain tasks on the figures being incorporated (§118). That is not the case. Instead, C&L Ireland performed an independent audit of CH Ireland. The results of that work were then incorporated by consolidation into the Canadian parent financial statements.

470. There is no expert opinion that C&L failed to take the steps required of them under GAAS that would entitle them to rely on the audited results of the subsidiary. Vance's report contained a criticism, but he admitted that he had misquoted the Handbook, confusing the obligations of the auditors.[521]

471. The Handbook provides that the primary auditor of a consolidated entity is entitled to rely on the secondary auditor of the component to be consolidated without re-doing or even reviewing that work, as long as certain conditions (s. 6930.07 and 6930.08) are met. No evidence exists that these conditions were not met.

472. The right to rely on another auditor's work is set out in s. 110(2)-(4) of the Act. No evidence exists that the reliance on C&L Ireland was unreasonable: the evidence merely goes to whether C&L Ireland itself did appropriate work and reached a correct conclusion. C&L Ireland were not on trial. If there was an error under GAAS by failing to note that the cash was restricted, this error was C&L Ireland's for which C&L Canada is not liable.

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520 Cunningham, Nov. 24, 1998, pp. 36-39; PW-508; PW-509. The heading above §116 of the judgment incorrectly implies that the Irish audit partner is a partner of C&L Canada.

521 Vance, June 6, 2008, pp. 17-18.

5) 1990

(a) LLPs

473. The same issues arise in 1990 as in 1988 and 1989. The same loans were considered (except for DTS) and the trial judge adopted her reasoning from 1988 and 1989 (with the same errors). Defendants identify some further errors unique to 1990 below.

474. DTS. The trial judge determined that a LLP was required for the DTS group of loans in 1990. She relied on Froese's report without considering that Froese testified that he had reviewed his report after delivering it and had changed his mind on a number of items. He summarized the impact of these changes on his proposed LLP for DTS, stating his low end would be reduced to about $35 million (rather than $45.5 million identified in §1708).[522] He further testified that he had used the 1990 DTS financial statements issued in 1992,[523] for the high end of his report computations, and when he was shown how the losses had been calculated for those statements, he testified it would be reasonable to remove the future interest component. This would reduce his high end LLP to the $30-$35 million range (rather than $49 million identified in §1708).[524]

475. In addition, hindsight errors caused the trial judge to err in respect of her judgments on objections #369-73, 402-07 and 409, 457 and 461 (cf. *infra*, paras 570-572), which led to a fundamental error in her conclusion on the DTS loan values. The trial judge concluded that Plaintiff's experts' opinions prevail (§2047). Their opinions rely on the 1990 audited financial statements of DTS showing a $40 million loss, which were only finalized in February 1992. The trial judge found that DTS's auditor and management were credible when they testified that DTS's auditor had reached his conclusion for 1990 in the spring of 1991, despite the further year's delay in producing the audited financial statements (§§2022-25). However, the evidence demonstrates that in

522 Froese, Dec. 2, 2008, pp. 112-14 (background starts at p. 92).
523 PW-2319.
524 Froese, Jan. 13, 2009, pp. 42-59.

February and March 1991, the same auditor prepared unaudited financial statements[525] for purposes of DTS tax returns, which DTS filed with the IRS and which showed losses of only \$13.5 million.[526] Using the \$40 million was hindsight, as was relying on Vance's opinion that depended on the "facts as they unfolded" (§2033).

476. Froese explained that the audited \$40 million loss included future interest and that once that was removed, roughly \$13.5 million of loss remained. Froese conceded that: a) this \$13.5 million loss arose from the application of US GAAP; b) US GAAP and Canadian GAAP differ, particularly in respect of real estate owners versus lenders; c) he had no authority to show that on this point US and Canadian GAAP were the same; and d) in any event, reasonable professionals could have decided to take the \$13.5 million loss in a subsequent year.[527]

477. <u>OSH.</u> In 1990, ownership of the OSH was moved from YH to a numbered company, 687292 Canada Ltd. The trial judge failed to consider whether the debtor had the capacity to repay, as there was no evidence adduced of 687292's financial condition.

478. <u>MEC.</u> The LLP analysis for MEC in 1990 is similar to 1988 and 1989, with the same errors, but contains a further reviewable error as it relies entirely on an appraisal which Castor did not have until after the 1990 financial statements were completed (§1892). Moreover, this appraisal[528] is not addressed to Castor, not signed and not on letterhead. Both Rosen and Froese testified that on these facts, it should not be used.[529] This also illustrates why it is inappropriate to assume that if C&L had asked for an updated appraisal, they would have received this one. Had the trial judge used

525 D-407, which combines D-405-1, D-434, D-432, D-430, D-439, D-437 and PW-2361-1 (and others not produced and some subject to the appeal on objections).

526 Strassberg Feb. 5, 2001, pp. 1754-1762, 1802-1805 and D-407 (referred to as DDTS-23 in the rogatory commission); Froese Jan. 13, 2009, pp. 50-51.

527 Froese, Dec. 9, 2008, p. 200, Jan. 13, 2009, pp. 42-59.

528 PW-1108B.

529 Rosen, Apr. 8, 2009, pp. 15-18; Froese, Jan. 7, 2009, pp. 140-41.

Castor's value estimate as communicated to C&L,[530] the difference in value would have been over $100 million.

479. YH. The trial judge referred to Vance's report for the proposition that the full $40 million of the loans created out of interest that had accrued on YH loans had to be written off (§1847). However, in cross-examination, Vance testified[531] that 1) this $40 million represents interest earned on other YH loans; 2) it was never repaid otherwise; 3) his analysis therefore assumed that YH was no longer liable for the debt, and that he would need a legal opinion to say otherwise, which he did not have. As seen above, under the *Singleton* case, his assumption was incorrect and therefore the trial judge's adoption of his opinion was an error of law.

480. In fact, Castor concluded that these loans were owed by YH (§1821), and the trial judge erred by determining collectibility without considering the guarantees signed by von Wersebe,[532] despite the evidence[533] that they had been agreed to before the financial statements were completed.

481. Castor did not identify these loans as YH debts, but as new loans to new companies. Dragonas designed them to appear to be unrelated to each other or to YH and for individual amounts that would fall beneath C&L's threshold for confirmation.[534] This was because by 1990, Castor was concerned that it would be unable to obtain sufficient security from the other YH assets to cover all YH indebtedness and had decided to seek an additional unrestricted $40 million guarantee from von Wersebe.[535] Not being certain it would succeed, it implemented a fallback plan.[536] Although ultimately von Wersebe agreed to and signed the guarantees and this fallback plan

530 PW-1053-15, p. 256 E-175.
531 Vance, July 7, 2008, pp. 202-3.
532 PW-1064-VM (series).
533 Alksnis, Feb. 7, 2006, pp. 182, 196-97, Feb. 8, 2006, pp. 54-57, 64-66, 71-73, 79-84.
534 R.B. Smith, May 15, 2008, pp. 105-13.
535 R.B. Smith, May 14, 2008, pp. 169-73.
536 PW-1053-15, pp. 130-1, E65d and E65e.

was not necessary, Castor preferred to keep its audit representations 'on an even keel' with its documented bank transfers, and YH was traditionally willing to assist.[537]

482. The trial judge ignored the evidence set out above and in her judgment regarding these loans (§§1807-14), and indicated that further questions by C&L would have elicited information leading to the discovery that these loans were in fact to YH. She dismissed Defendants' arguments regarding their entitlement to rely on management's good faith by stating that while "*fraud might have been a barrier to the auditors identifying irregularities, the alleged fraud and misrepresentations by Castor's management cannot serve to relieve C&L of the responsibility arising from their improper and deficient performance as accountants and auditors*" (§2763).[538]

483. This confuses the respective roles of the auditor and management. An audit is predicated on management's good faith,[539] and the test is what a reasonable auditor would do in <u>similar circumstances</u>. If the audit environment is ignored, an inappropriate legal test has been applied.[540] Also, the trial judge's approach does not account for the fact that misrepresentation can be accomplished by misdirection, which leads the auditor to ask the 'wrong' questions. The trial judge therefore failed to properly consider how Castor's misrepresentations interfered with the normal expectations that an auditor would have and the types of testing he would perform.[541]

484. This also contradicts the long-standing principle that auditors are watch-dogs, not bloodhounds.[542]

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537 D-213.

538 *Ford du Canada v. Duclos*, *supra* note 363, holds that a judge cannot be blinded by one party's behavior to the point of completely overlooking the other's (cf. para. 129).

539 Vance, Apr. 16, 2010, p. 33; PW-1419-2A Handbook s. 5300.53.

540 Gourdeau, Jan. 31, 2008, pp. 35-36 and Judgment on Objections, §606.

541 For example, if nobody tells the auditor that Stolzenberg, Widdrington and Bänziger were directors of Trinity, the auditor will not ask specific questions about the factual role they played in Trinity's decision-making.

542 §§275-276 (and footnotes). See also: *Barings* v. *Coopers & Lybrand,* [2002] EWHC 461 (Ch), paras 31-6; *TD Bank* v. *Mazur,* 2002 (C.S.) AZ-50132245.

485. The correct question that must be asked before determining that the auditor's failure to ask certain specific questions can be said to have **caused** the damage is whether, on a balance of probabilities, had they followed up as suggested, the reply would have caused concern rather than have elicited further corroborative evidence. Froese could not come to that conclusion (§§2856-59) and the trial judge did not disagree.

486. This 'missing link' is also evident in §§2946-48. There is no finding as to what Castor would have replied to the proposed audit question. As Plaintiff's experts testified, audits are interactive,[543] so one cannot know what the result would be of a further question that an auditor might ask. Plaintiff never asked that question of the witnesses, nor called the witnesses who would have known the answer.

487. As the trial judge correctly stated at §§271-72, financial statements are prepared by management and an audit does not relieve management of its responsibilities. Preferring to load the responsibility on the auditors rather than management is directly contrary to the Handbook[544] which states that management (which expressly includes directors) has the primary obligation to prevent and detect fraud (§§2847 and 2849). The statement that "*...inaccuracies in management representation letters do not exempt C&L from their professional obligations...*" (§2935) is to be contrasted with s. 5000.02 which states "*...An audit of the financial statements does not relieve management of its responsibilities...*".

488. There is no inconsistency between the defence experts' opinions that the loans were recorded at proper value in the statements (a GAAP issue), once the actual facts are known, and the fact that Castor made misrepresentations to C&L (a GAAS issue)

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543 Froese, Dec. 3, 2008, pp. 107-12; Vance, June 4, 2008, pp. 38-39, Apr. 18, 2008, pp. 54-59; Rosen, Feb. 20, 2009, pp. 236-37.

544 PW-1419-2A, s. 5000.02.

(§324). The judgment in *TransAmerica*[545] is an example of this: the company was dishonest about its inventory, but the financial statements met GAAP.

(b) 1990 Disclosure Issues

489. The RPT that the trial judge identifies for 1990 is the loan from Castor to 687292 (§2617). This conclusion is based uniquely on corporate documents showing Stolzenberg's titles. This is contrary to the GAAP rule that looks beyond the title to the actual role (see *supra*, para. 436).

C) VALUATION LETTERS – LEGAL-FOR-LIFE CERTIFICATES

490. The trial judge's conclusion that the Valuation Letters and Legal-for-Life Certificates issued during 1988 were "faulty" is *ultra petita* and based on no evidence. As is clear from these two Letters and the Certificate,[546] they refer to the 1987 financial results. This trial was only concerned with the 1988 and subsequent financial statements. In addition, it is clear from the evidence that Widdrington did not rely on any of the 1988 Letters or Certificates.

491. The judgment on the post-1988 Valuation Letters is derivative of the conclusions on the financial statements (§3054). Therefore, any errors made by the trial judge with respect to the latter would invalidate the judgment regarding the Valuation Letters. Vance testified that if there is no problem with the financial statements, then he would not criticize the Valuation Letters.[547]

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545 *TransAmerica Commercial Finance Corp., Canada* v. *Dunwoody & Co.* (1996) B.C.J. no. 828 (BCCA), paras 42-46.

546 PW-6-1; PW-1053-5A (seq. pp. 219-20).

547 Vance, June 12, 2008, p. 134.

1) Valuation Letters

492. In order to reach a conclusion of negligence on the issue of the Valuation Letters, the trial judge had to make the following findings which have no basis whatsoever in the evidence and, in some cases, contradict the only evidence that was adduced.

493. The main finding (adopted literally from Plaintiff's written argument) was that the Valuation Letters were valuation reports of the fair market value of Castor's common shares "*to be used and used for fund raising purposes and C&L knew it*".[548] In other words, the Valuation Letters were valuation reports in the general sense, meant for the public at large.

494. That finding was necessary in order to subject the preparation of the Valuation Letters to whatever professional standards may have been applicable to valuations at the time, if any (in the case of Widdrington, 1989-1991).

495. The trial judge had to disregard and contradict the only evidence that was adduced which shows conclusively that as far as C&L were concerned these letters were meant for the directors of Castor only, and were connected to the Restated Shareholder Agreement in the sense that they served as the "valuation report" referred to therein.[549] The purpose and nature of the Valuation Letters appears unequivocally from the letters themselves (see October 17, 1989 letter – PW-6-1), the evidence of Wightman[550] who signed them for C&L, and the evidence of Dennis,[551] a director and Corporate Secretary of Castor at the relevant time.

496. The letters were all addressed to Stolzenberg as Chairman, President and Chief Executive Officer. Widdrington testified that he understood that the letters were intended for the directors and that their purpose was related to the mechanism referred

548 §3063, compare to pp. 208 ff. of Plaintiff's written argument.
549 PW-2382.
550 PW-6-1; Wightman, Aug. 13, 1996, pp. 22-24, 104-05.
551 Dennis, Sept. 8, 1995, pp. 67-68.

to in the Restated Shareholder Agreement.[552] The first paragraph of the October 1989 letter concludes as follows:

> *"The purpose of this valuation is to update previous letters relating to valuations of shares of Castor prepared at various dates and for the information of the directors."*

497. The trial judge concluded that there was a link between the Valuation Letters and the Restated Shareholder Agreement, and that they were used as the "valuation report" mentioned in the Agreement. But she went beyond the evidence to hold that this was not the only purpose.[553]

498. To support this conclusion, the trial judge relied on inferences from four (4) elements that do not support the conclusion.[554] The letter may have been issued more often that the Restated Shareholder Agreement mandated, but frequency has no impact upon the nature of the letters. Moreover, the trial judge failed to mention that the letters were issued twice yearly, always close to a board of directors meeting.[555] Wightman's testimony on this point was corroborated by Dennis: a Valuation Letter was tabled at every meeting of the board of directors.[556]

499. As seen above (para. 496), the Valuation Letters contained specific wording as to purpose and for whose information they were prepared. If one combines this with the fact that the letters were addressed to Stolzenberg and their timing, it was redundant for them to include the reference to the Restated Shareholder Agreement. Widdrington certainly did not think otherwise in the absence of any specific reference, and the trial judge recognized that Widdrington made a connection between the October 17, 1989 Valuation Letter and the definition of "valuation report" in the Restated Shareholder Agreement (§2973).

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552 Widdrington, Dec. 17, 2004, pp. 14-15, 17-19; Wightman, Feb. 10, 2010, p. 138.
553 §3056.
554 §3057.
555 Eg. PW-2378; PW-12-4; PW-14-1; PW-15; PW-51.
556 §2974. Also: Wightman, Aug. 13, 1996, p. 106, Feb. 10, 2010, p. 154; Dennis, Sept. 8, 1995, pp. 67-68.

500. As for Defendants' Plea, it states that the purpose of these letters was to assist the company and the letters contained no language that could be interpreted to mean that they were meant for a larger audience.

501. The trial judge found that since there was no definition of "fair market value" in the letters, reference to the definition used by valuators was appropriate (§3059). This conclusion disregards the fact that the Restated Shareholder Agreement, PW-2382, sent to Widdrington at the time of his December 1989 investment, contained a definition of "fair market value", and that the letters indicate that C&L were acting as auditors or professional accountants, not as valuators.

502. The trial judge concluded without evidence that C&L knew that the Valuation Letters were used for fundraising purposes, and even more astounding, that the absence of a reference to the Restated Shareholder Agreement was not an oversight by C&L, but "*it was a conscious gesture*" (§§3063, 3065). Even the Plaintiff in his most aggressive pleading never went that far! Furthermore, both Wightman, the preparer, and Manfred Simon, Castor's principal fundraiser, testified that C&L was not aware that the Valuation Letters were distributed to prospective investors.[557] The trial judge also stated that the failure to include a disclaimer was "a conscious gesture". In fact, contrary to §3529, no disclaimer was permissible.[558]

503. The Valuation Letters were prepared for the purposes of the application of the Restated Shareholder Agreement, for the directors and not the public at large. As such, they were not subject to any standards, and certainly not the standards referred to in the judgment and John Kingston ("Kingston")'s testimony. In any event, the CICBV standards 91-1 did not come into effect until 1992.

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557 Footnote 3235 of the judgment; Wightman, Aug. 13, 1996, pp. 91, 92 where he explains that multiple copies were made because there were 40 to 50 shareholders, some of which were corporate entities; Wightman, Feb. 10, 2010, pp. 131-38; Simon, June 17, 2009, pp. 51-52.

558 PW-2311, s.3.01.06.

504. The first paragraph of the CICBV Code of Ethics states clearly that it applies to the members of the Institute.[559] Wightman was not a member and he signed the letters for C&L as accountant and auditor, bound by his professional Code of Ethics.[560]

505. In addition, each letter was an update to a chain of letters dating back to the early 1980's (PW-6-1) when the CICBV Code did not exist. Further, the Restated Shareholder Agreement mandated that the letters be prepared on a basis consistent with prior years, and this clearly appears in the letters.

506. In order to fill this regulatory and evidentiary vacuum (§3031), the trial judge, following Kingston, referred to C&L's own internal material (§3029). The trial judge completely ignored that these are not a generally applicable standard as well as Wightman's testimony to the effect that the letters were not subject to C&L's internal material, and that they did not constitute a valuation assignment within the meaning of C&L's internal technical policy statement TPS-A-602.[561]

507. In any event, such material could not constitute a standard, in the absence of a Code of Ethics, especially toward third parties like Widdrington, who in 1989, had no legitimate right to expect its application.

508. Kingston's basic error, aside from seemingly confusing the date when the CICBV standards came into force, was that he testified that an opinion requires that all the work necessary be done "*because it is assumed that all such work has been done*" (§3025). This assumption is inapplicable to the present case, where the letters were clearly intended for a very restricted, knowledgeable audience who gave the instructions and information used, and which are completely transparent as to their scope and the work done. This erroneous assumption then directly led to Kingston's

559 PW-3037, Appendix 2-B to 2-J.

560 PW-2311.

561 PW-1420-1B, para. 2 (re exception for previously agreed formula); Wightman, Feb. 10, 2010, pp. 144-49.

opinion as to the deficiencies: §§3029 and 3033. This error was adopted by the trial judge.

509. Finally, the Valuation Letters speak for themselves in a clear and unequivocal fashion. Whatever one may conclude as to their precise nature, the fundamental fact remains that the letters are clear as to whom they were intended and for what purpose, and they could not be clearer in terms of what they told the reader as to the nature of the work performed in order to arrive at a conclusion. Defendants refer to PW-6-1 as an example and the sections entitled in bold capital letters **THE SCOPE OF INVESTIGATION** and **MAIN CONSIDERATIONS IN ESTABLISHING VALUE**.

510. That the Valuation Letters were, on their face, not formal valuation reports subject to CICBV standards that were not yet in force is supported by Defendants' experts Selman and Morrison.[562] These opinions were ignored by the trial judge.

511. Finally, Widdrington confirmed his understanding that the share valuation of $525 and $550 per share found in the October 17, 1989 letter was essentially a multiplication of the book value by the lower end of the range (1.5) of the price to equity ratio referred to in the third paragraph at page 5.[563] He also confirmed his understanding that the Valuation Letters and the financial statements were tied together and went so far as drawing a diagram (D-632) showing that the fair market value of the shares was calculated by using, as a starting point, the information contained in the financial statements.[564] He further conceded that there was no genuine market *per se* for Castor's shares.[565]

562 Selman, May 26, 2009, pp. 170, 171; Morrison, Oct. 4, 2006, pp. 78-79.
563 Widdrington, Dec. 17, 2004, pp. 40-41.
564 Widdrington, Dec. 17, 2004, pp. 19-26, 42 and D-632.
565 Widdrington, Dec. 17, 2004, pp. 42-43.

2) Legal-for Life Certificates

512. These were entirely derivative of the preceding year's financial statements (§3105), so any errors in the judgment on the financial statements would invalidate the judgment on these certificates.

513. In addition, on the facts as found by the trial judge, the only party that could have been sued by Widdrington is McCarthy Tétrault, the firm that issued the Legal-for-Life opinion on which he would allegedly have relied. Since Widdrington never saw the Legal-for-Life Certificates that C&L prepared for Castor and transmitted to its lawyers, there is no actual reliance on any C&L representation.

SECTION IV - JOINT LIABILITY OF NAMED PARTNERS AND COSTS

A) THE TRIAL JUDGE ERRED IN LAW WHEN SHE CONCLUDED THAT THE INDIVIDUAL PARTNERS WERE SOLIDARILY LIABLE FOR THE DEBTS OF THE PARTNERSHIP

514. The Plaintiff is claiming damages from C&L, the partnership, and from its partners. This raises the issue of whether these partners are solidarily liable or only liable for their share of any partnership's debt. As noted by the trial judge, although C&L is an Ontario partnership, that issue must be decided according to Quebec law because none of the parties invoked or proved Ontario law on this issue (§3597).

515. The trial judge concluded that, under the provisions of the CCLC, C&L's individual partners for the relevant years are solidarily liable to the Plaintiff. She rejected the application of the clear provisions of art. 1854 CCLC, on the basis that this only applied to contractual debts, not to the extracontractual liability of the partnership. She therefore concluded that art. 1856 CCLC, which referred to the general rules of mandate, applied. She then concluded that art. 1731 CCLC rendered the partners (mandators) liable for the acts of the individual partners and the partnership's employees according to art. 1054 CCLC, and that such liability was solidary on the basis of art. 1106 CCLC, which state that "*the obligation arising from the common*

offence or quasi-offence of two or more persons is joint and several." (§§3597-3603). This conclusion is an error of law.

516. Under the provisions of the CCLC, a partnership of accountants is considered a civil, not a commercial partnership,[566] with the consequence that in accordance with the unequivocal text of art. 1854 CCLC, the individual partners are liable in equal shares (irrespective of their shares in the partnership) for the debts of the partnership.

517. The trial judge erred in law in restricting the application of art. 1854 CCLC to contractual debts, as opposed to other debts, of the partnership, as the text of the provision does not make any such distinction. The only decision that she cites in support of such a restriction in footnote 3853 of the judgment (*Bélisle-Heurtel v. Tardif*) is not relevant to the issue, as it deals with an article of the *Quebec Civil Code* which is totally unrelated to the former art. 1854 CCLC.

518. More importantly, the trial judge failed to mention the decision of the Supreme Court of Canada in *Pérodeau v. Hamill*[567] (although it was pleaded to her by Defendants' attorneys) which held that the liability of the partner in a civil partnership *for the debts of the partnership* is not solidary, according to the provisions of art. 1854 CCLC, without mention that this would only apply to contractual debts as opposed to other debts of the partnership. The Supreme Court expressly stated that the distinguishing factor between art. 1854 and 1856 CCLC is not the nature of the liability, as being contractual or extracontractual, as found by the trial judge, but rather whether there is a *partnership debt*:

> *"(...) in this case the appellant's liability is not for the act of his partner or nominal partner; it arises by reason of the fact that the partnership has failed to account for, or to apply to the purpose directed, the money which was received by the partnership for that purpose. The money was paid to Mr. McKenna who had authority to receive it and did receive it on behalf of the firm (...).* ***Hence arose at***

566 *Pérodeau* v. *Hamill*, [1925] S.C.R. 289; *Bastien* v. *Beaulac*, JE 2000-1963 (C.S.); *Samson Bélair* v. *Autobus Fortin & Poulin inc.*, JE 87-634 (C.S.).

567 [1925] S.C.R. 289

> ***least a debt of the partnership to repay the money, if the mandate was not executed, and for this art. 1854 declares that the partners are liable to the creditor not jointly and severally but in equal shares; this article regulates the measure of the appellant's liability because it is a partnership liability and because, with respect to partnership liabilities, the article is not controlled or qualified by the provisions respecting mandate.***" [emphasis added]

519. It was C&L, the *partnership*, which was Castor's auditor and not Wightman. The shareholders' resolution appointing the auditor state that the auditor is C&L, and the appointment of a partnership of auditors to hold the office of the auditor is expressly permitted by art. 1(1) of the Act. Therefore, any extracontractual liability of the *auditor* vis-à-vis the Plaintiff would clearly be a debt of the partnership, thus making art. 1854 CCLC applicable and excluding the application of the rules of mandate.

520. In any event, solidarity, as it is not presumed, must be expressly provided for by law (art. 1105 CCLC). The trial judge held that the individual partners were solidarily liable by application of art. 1106 CCLC. This is also an error in law. This article only applies to situations where a delict or quasi-delict has been committed by one or more persons, who are all at fault. It does not apply to situations where one person may be legally liable for the fault or act of another person or entity. This was clearly indicated by the Supreme Court of Canada in *Modern Motors Sales Limited* v. *Masoud*:[568]

> "*J'entretiens des doutes sérieux sur l'existence de cette solidarité entre les trois défendeurs. En effet, elle ne pourrait exister que par l'application de l'article 1106 C.C. (...).* ***Encore faut-il que les débiteurs aient commis un quasi-délit et que ce soit le même quasi-délit. C'est à cette seule condition qu'il y a aura solidarité.*** *Dans le cas qui nous occupe, l'obligation de Picard, conducteur du véhicule, de réparer le dommage causé procède bien d'un quasi-délit, mais les sources qui font naître les obligations de Masoud et de Montreal Candy sont entièrement différentes.* ***La responsabilité de Montreal Candy (...) naîtrait de la relation d'employeur et d'employé (art. 1054 C.C.). Elle aurait son fondement sur un texte de loi et ne présenterait aucun caractère quasi-délictuel.***" [emphasis added]

568 [1953] 1 S.C.R. 149, p. 156.

521. Again, the reasoning of the trial judge is in complete contradiction with the foregoing analysis of the Supreme Court and again the trial judge failed to mention this decision in her analysis, although pleaded by the Defendants' attorneys.

522. As a consequence, the liability of the individual Defendants for the debt of the C&L partnership, if any, is not solidary, as decided by the trial judge, but must be divided between them in equal shares.

B) COSTS AND ADDITIONAL INDEMNITY

523. The trial judge condemned the Defendants to pay the full costs of both the first and the second trial with interest and the additional indemnity, including the costs of all Plaintiff's experts for both trials.

1) The trial judge manifestly erred in condemning the Defendants to pay all of the costs on the common issues in the Widdrington trial

524. In the unique procedural framework of the present file, that is to say a test case on the common issues (negligence, rule of conflict for the applicable law) but not on others (causality/reliance, damages), it is manifestly unjust, and an error of law, to condemn the Defendants to pay all the costs to one Plaintiff in one case, including the costs on the common issues, without even knowing if the actions of the other Castor plaintiffs in the other Castor actions will succeed.

525. As recognized by the trial judge, Defendants are right (§3638) to say that it is possible that a Court will dismiss the other Castor plaintiffs' claims in the other pending Castor actions if they do not discharge their burden to prove causation or damages, but she nevertheless refused to share on a *pro rata* basis the costs related to the evidence on the common issues amongst all these cases on the basis that these other actions might be resolved otherwise than by a judgment following a trial. This is a totally irrelevant consideration.

526. Plaintiff's claim was for an amount of $2.7 million or 0.4 of 1% of all the Castor actions pending against Defendants. Manifestly the enormous costs incurred in relation to the common issues – millions of dollars – would not have been incurred for the sake of Plaintiff's claim alone, but were incurred by all sides because his case was transformed into a **test case** on the common issues for all pending Castor actions amounting to more than $600 million in 1993 dollars. In fact, all of the other Castor plaintiffs had standing to adduce evidence in the present case on the common issues and one, Chrysler, participated throughout via their attorneys.

527. In light of these unique circumstances, the only fair solution as to the costs related to the trial on the common issues is the one proposed to the trial judge by the Defendants at trial, namely that all the costs related to the common issues incurred in the Widdrington case should be dealt with on a *pro rata* basis with all the other pending Castor actions.

528. Defendants submit respectfully that the proposition put forward by them is the only one which could have been adopted as the result of a properly and judicially exercised discretion by the trial judge. The latter's rulings on the issue of costs leads to a flagrant and serious injustice to Defendants and could create a serious injustice to the Plaintiff.

529. Indeed, if this Honourable Court maintains the appeal and reverses the *judgment*, it would be manifestly unfair for Plaintiff – whose claim is only for $2.7 million – to bear all the costs, including the costs related to the common issues. Similarly, if the appeal is dismissed, it would be unfair to condemn the Defendants to pay in this case all the costs on the common issues without knowing if the other Castor actions will succeed or not

530. The solution put forward by Defendants on the sharing of costs is also in line with the principles adopted by the other main Castor plaintiffs, as appears from the "Participation Agreement" they adhered to.[569]

531. The trial judge's ruling on costs manifestly fails to consider that the Widdrington case is unique in Quebec jurisprudence in that it is a "test case" on some issues only, and that this way of proceeding was imposed on the Defendants. Even if it were to dismiss the appeal on the merits, the intervention of this Court would therefore be warranted to correct such a patent injustice and to order that the costs related to the trial of the common issues be dealt with on a *pro rata* basis in each case. This issue in itself is potentially worth several million dollars, taking into account the fact that the Bill of Costs that has been presented for taxation amounts to approximately $15.7 million dollars and Plaintiff's attorneys' claim to a special fee of $10 million dollars.[570]

532. The application of the *pro rata* solution would lead to a condemnation of Defendants to pay in this case – should their appeal fail – only 0.4 of 1% of the taxable costs on the common issues and on the special fee.

2) The trial judge erred in condemning the Defendants to pay the full costs of the first trial and the additional indemnity

533. According to art. 466 CPC, when a judge is called upon to hear a new trial, he or she "shall rule on the costs, including those relating to the original inquiry and hearing, <u>according to circumstances</u>".

569 Participation Agreement dated May 25, 1993 (R-17 in support of *Requête amendée des défendeurs afin de faire rejeter du dossier certains affidavits et afin d'être autorisés à déposer au dossier des extraits de procédures produites ou d'interrogatoire sau préalable effectués dans le cadre d'autres dossiers Castor*).

570 *Plaintiff's Amended Motion to Quantify the Special Fee* dated August 8, 2011; *Plaintiff's Bill of Costs* dated July 21, 2011.

534. When the first trial was aborted, due to Justice Carrière's health issues, the Chief Justice ordered *a new trial* as opposed to the continuation of the first hearing.[571]

535. Since the trial was a new trial, and not a continuation of the original hearing, it was agreed by Plaintiff and Defendants that most of the original expert evidence that was adduced (namely the evidence of the accounting and auditing experts), and which had consumed most of the first trial, would not be filed in the new trial. In *Massinon* c. *Ghys*,[572] it was decided that expert reports that were filed in the Court record but not used by the parties or the Court cannot be taxed. Defendants submit that this reasoning should apply to the expert reports and testimonies from the first trial which do not form part of the second trial, and that no costs should be awarded in respect of same.[573]

536. Defendants cannot be blamed for the fact that the first trial aborted, nor can they be blamed for the unusual length of the original inquiry and hearing.

537. For example, more than 48 days (one third of a judicial year) of Vance's testimony in the first trial was devoted to "corrections" to his testimony in spite of Defendants' vigorous objections.

538. The "correlation exercise" that was done by Vance at the instigation of the Plaintiff during the first trial to compare the documents found in the Trustee's files with those referenced in the audit working papers, and which was allowed by Justice Carrière under the express undertaking of Plaintiff's attorneys that it would take "between one and two days" lasted in fact approximately 29 days in chief (to be contrasted to less than one hour in the second trial).[574]

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571 *Ordonnance selon l'article 464 du Code de procédure civile rendue le 7 septembre 2007.*

572 J.E. 98-1195 (C.A.).

573 *Procès-verbal* dated Jan. 7, 2008, with Annex D.

574 Vance, March 21, 2001, pp. 4-5; Vance, Apr. 5, 2001, pp. 78-79; Vance, Apr. 10, 2001, pp. 4-11 at p. 10.

539. Further, Vance testified in chief for 107.25 days in the first trial and 11.5 days in re-direct.

540. This is to be contrasted with his testimony in the second trial, where Vance spent 11.5 days in chief, 1.5 days in re-direct and 4 days for rebuttal.

541. The foregoing, which was not considered by the trial judge in the exercise of her discretion, unequivocally demonstrates that the trial judge's order on costs is totally unreasonable and leads to a manifest injustice, in that Plaintiff adduced the same opinion evidence from the same expert in the second trial in 10% of the time.

542. The trial judge's reference in paragraph 3634 to the experts' invoices and that "*neither Plaintiffs nor the Defendants challenged the quantum of same*" is both incomplete and mischaracterizes the reasons why the invoices were filed during the first and second trials. In the first trial, the invoices of the experts whose testimony was imported into the second trial by agreement of the parties and consent of the Court were filed at the end of their evidence in chief. This was not done for the purposes of either party challenging the quantum of same.

543. With respect to the second trial, towards the end of Rosen's examination in chief, Defendants requested the production of his invoices for the purposes of cross-examination. Plaintiff objected to same. Following representations as to the purposes of the request, namely cross-examination on methodology and other credibility issues, and further to a suggestion of the trial judge, the parties agreed that the non-redacted invoices of each expert to be called by the parties would be filed at the end of their testimony in chief.[575] The issue of the quantum or reasonableness of the amounts charged by the experts was never addressed during the second trial, whether in cross-examination or in the written or oral argument. As such, the "fact" that the quantum was not challenged is due to the fact that this issue never arose, and it is a mischaracterization for the trial judge to suggest, implicitly or explicitly, otherwise.

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575 Rosen, Feb. 5, 2009, pp. 158-76.

544. Indeed, as appears from the costs questions that the parties were ordered to address in written and oral argument, the issue of costs was secondary, and amounted to less than two (2) pages of the written argument of both parties, and approximately one (1) hour of oral argument.[576] Consequently, the parties did not address in any detail, for example, the "circumstances" that led to the undue length of the first trial, or the testimony and reports of the accounting and auditing experts who testified in the first trial.

545. This Court held in *BMW Canada inc.* v. *Automobile Jalbert Inc.* as follows:

> *"[249] Il est acquis qu'en matière de dépens, la Cour n'intervient qu'exceptionnellement compte tenu du pouvoir discrétionnaire dont jouissent les juges de première instance en cette matière (art. 477 C.p.c.); la Cour n'interviendra pas si cette discrétion est exercée judiciairement mais elle n'hésitera pas à le faire si la décision du premier juge crée une injustice réelle ou manifeste."*[577] [emphasis added]

546. Defendants submit that the judgment demonstrates that the trial judge did not exercise her discretion judicially and relied on erroneous legal standards. The trial judge concluded (§3619) that under article 477 C.C.P., the Defendants had the burden to convince the Court not to order the payment of all costs. This is an erroneous analysis of the burden of proof in respect of costs. Further, the trial judge completely omitted any analysis of the second paragraph of article 477 C.C.P., which sets out the requirement for the Court to reduce costs, and notably experts costs where, for example, one expert would have sufficed.

547. The trial judge then further failed to exercise her discretion in respect of her award of costs for the first trial. Nowhere does the trial judge analyze the reasons why the first trial unfolded as it did; rather, she deals with the undue length of the first trial (and

576 *Procès-verbal* dated May 19, 2010 with annexes; Defendants' Written Argument, pp. 263-64; Plaintiff's Legal Arguments, p. 299, Aug. 30, 2010, pp. 11-12; Procès-verbal of Sept. 7, 2010 with Annex; Sept. 30, 2010, pp. 233-39, Oct. 1, 2010, pp. 184-96.

577 [2006] QCCA 1068, p. 54.

implicitly the testimony of Plaintiff's expert Vance) by erroneously suggesting that the parties did not have the obligation to adduce their case in a reasonable manner and that Justice Carrière did not have the power to see to the orderly progress of the first trial prior to the adoption of articles 4.1 and 4.2 of the C.C.P. in 2003, and finally, by suggesting that she could not rule otherwise on the costs of the first trial as this would be "hindsight" (§3631-§32).

548. This is an error of law. The obligation to adduce a case in a reasonable manner and trial management discretion existed prior to 2003. The trial judge had the obligation to exercise her discretion under article 466 C.C.P. and the issue of adjudicating costs for the first trial is not hindsight, but what article 466 C.C.P. requires, in that it expressly called upon her to decide the issue of costs of the first trial "according to the circumstances". This therefore necessitated an analysis by her of the reasons for the undue length of the trial and why the first trial could not be completed (and, for example, in this case, the reasons why the evidence of Plaintiff's expert Vance took so long to adduce).

549. The trial judge clearly failed to consider these circumstances. The judgment is silent on the reasons for the unusual length of the first trial, other than the statement that, with the benefit of hindsight, "*one could think that the case should have unwound differently*" (§3631).

550. Defendants therefore submit that, in these circumstances, the trial judge did not exercise her discretion in a judicial manner when she condemned them to the full costs of the first trial, including the full costs of experts, without any analysis and without any consideration of the above factors but simply on the basis that they were not successful in their defence and that the expert opinions were "useful".

551. In light of the special and unusual circumstances described above, and except for the costs related to evidence that was used in the second trial, no party should be responsible for the costs of the first trial, including the costs of experts.

552. For the same reasons, if the present appeal is dismissed, Defendants should not be condemned to pay the additional indemnity for the full period between the introduction of the Plaintiff's action and the date of judgment, as no responsibility can be assigned to Defendants for substantial parts of that unusually long period of time.

553. Finally, the Defendants submit that they should certainly not bear the costs related to the new expert testimony introduced by Plaintiff in the second trial should this Court rule that such introduction was illegal, as submitted. Even if such introduction is ruled to be legal, this Honourable Court should take into account that Plaintiff's attorneys took the position in their written argument that expert evidence on GAAP and other issues was not necessary in the present case and implicitly invited the Court to set them aside.[578] This position was not referred to, nor considered by the trial judge in assessing costs.

554. Subsidiarily, the trial judge should have reduced the costs of the Plaintiff's accounting and auditing experts and the reliance experts.

555. A court should not award costs for multiple experts on the same issues when a single expert would have been sufficient.[579]

556. While a party is at liberty to call more than one (1) expert on the same issue, the other party should not bear the costs of this decision. Plaintiff called three (3) accounting and auditing experts who all essentially addressed the same issues. A single expert would have sufficed. A proper administration of justice requires that superfluous costs be limited and "les dédoublements d'expertises en font partie".[580]

557. This is particularly the case here, where, during the first trial before Justice Carrière, Plaintiff closed its proof after having called only one accounting and auditing expert,

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578 Plaintiff's Rebuttal Argument, pp. 6-7.

579 *Simard* v. *Larouche*, [2011] QCCA 911; *Gadoua* v. *Beaudoin*, REJB 1999-14586 (AZ-99021856).

580 *Simard* v. *Larouche*, *supra* note 579, at p. 22.

Vance. Plaintiff, by its conduct of the first trial, therefore admitted that a single accounting and auditing expert was sufficient.

558. The foregoing principles should also apply to the fact that Plaintiff called two (2) experts on reliance (causality), Jarislowsky and Lowenstein.

559. The trial judge therefore did not exercise her discretion on expert costs in a judicial manner and her judgment creates a real and manifest injustice.

SECTION V - APPEAL NO. 2 (OBJECTIONS)

A) QUESTIONS IN DISPUTE

1) **Did the trial judge err in maintaining part of objection 71, and objections 80, 126, 127, 402-407 and 409?**

2) **Did the trial judge err in dismissing objections 88, 369-373, 454, 455, 457 and 461?**

B) ARGUMENT

560. The argument to follow addresses the decisions made in the judgment on some objections (objections #71, 80, 88, 126, 127, 354, 369–373, 455, 457 and 461) referred to in Inscription in Appeal No. 2.

561. **Objection 71.** The trial judge's decision to maintain part of objection 71 to Goodman's testimony relating to the relevance of accounting principles used by other lenders in 1988 is erroneous (§415, judgment no. 2). These principles and their application by other lenders constitute a source of GAAP, as the trial judge recognized in §449 of the principal judgment.

562. **Objection 88.** An example of the trial judge's reasoning being influenced by hindsight and Castor's bankruptcy in 1992 is her decision on objection 88, wherein she

concluded that it was relevant to an assessment of Goodman's methodology and credibility to know whether he was aware that the first ranking creditor, Bank of Montreal, had not recovered its $125 million loan after it took possession of the MEC following Castor's bankruptcy in 1992 (§486, judgment no. 2).

563. The amount that may have been obtained after Castor's bankruptcy in 1992 (and Defendants note that Plaintiff offered not a shred of evidence in support of the factual assertion implied in the question nor any evidence with respect to the extent of the loss) was irrelevant to an assessment of Goodman's methodology, which presumed that first ranking creditors would be paid in full.[581] It was also not publicly available information, such that it would not have been considered by Goodman under his methodology.

564. **Objections 80, 126 and 127.** The decision maintaining objections 80, 126 and 127 relating to the production of exhibits D-846, D-846T, D-848, D-1351 and D-1353 (§§456, 457, 679, 680, 681, 691, 692, 693, judgment no. 2) illustrates the trial judge's inconsistent application of hindsight to the documentary evidence. The trial judge erroneously applied the hearsay rule. In addition, the decision is an example of her inconsistent reasoning in respect of the principles applicable to the admission of evidence.

565. Exhibit D-846 is a YH business record, and may be admitted under the business record exception (art. 2870 C.C.Q.). Moreover, the reasoning applied by the trial judge in respect of objections to other exhibits that she admitted, such as PW-3089 and the unaudited YH financial statements[582] demonstrates her inconsistent application of the same evidentiary principles.

566. With respect to the date of exhibit D-846 (July 1991), it is within the time period deemed relevant by the trial judge for the admission of other evidence and exhibits. Its

581 §828.
582 Judgment on Objections, paras 39-46; *procès-verbal* of Dec. 7, 2009.

rejection is to be contrasted to the reasoning employed by the trial judge in §1902 of the judgment with respect to the unsigned and undated MEC appraisal (PW-1108B) that Smith testified was only known to Castor in July 1991. The trial judge's reasoning was that if an appraisal would have been requested in February 1991, the information contained in PW-1108B would have been received. Using the same reasoning, the information in D-846 regarding the 1990 financial results of YHAG used by Goodman to assess the value of von Wersebe's personal guarantees would, if requested, have been known to Castor in 1990. Moreover, this reasoning is to be contrasted with the trial judge's reasoning in respect of exhibits D-848, D-1351 and D-1353 below.

567. Finally, the exhibits and testimony objected to should have been authorized further to the rule that an expert may refer to hearsay evidence when providing his opinion.[583]

568. **Objections 126 and 127.** With respect to objections 126 and 127, the trial judge manifestly erred in her refusal to permit the introduction of exhibits D-848, D-1351 and D-1353 (personal net worth statement of von Wersebe, the 1987 audited financial statements of Raulino and a memo written by Mr. Quigley) because they were based on documents and information not in the record, and therefore hearsay. This is an erroneous application of the hearsay rule and, as stated above, inconsistent with her reasoning on objections to other exhibits.

569. Mr. Quigley identified all of the source materials that he relied upon to prepare the net worth statements and the memorandum.[584] Defendants were not obliged to produce the supporting documents relied upon; indeed, if such was the proper application of the hearsay rule, then, for example, Defendants' objection to all of the unaudited financial statements of YH produced by Plaintiff should have been maintained, as they were all based on YH source records not in evidence.

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583 *R. c. Lavallée*, [1990] 1 S.C.R. 852.
584 Quigley, March 15, 2010, pp. 74-95, 106.

570. **Objections 369-373, 454, 455, 457 and 461.** The trial judge erred in law in dismissing objections 369-373, 454, 455, 457 and 461 (§§800, 801, 803, 1056, 1057, 1070, 1071, 1072, 1088, 1089, 1090, 1108, 1109, 1110, decision no. 2). These decisions illustrate the overriding and palpable errors made by the trial judge in respect of hindsight. The testimony and exhibits in question, provided to the Court by the auditor of DTS (Strassberg) after consulting working papers prepared in 1992 and 1993 relating to the 1991 and 1992 audits, were used by him in order to testify as to what conclusions he reached for the 1990 audit of DTS. This was permitted on the basis that the 1990 audit working papers had been destroyed in the normal course. Plaintiff failed to show the required diligence to avoid the destruction of the 1990 working papers, and thus did not meet the standard of article 2860 C.C.Q.[585]

571. This was a determinative error, as the trial judge adopted Strassberg's evidence relating to the financial condition of DTS as at December 31, 1990.

572. **Objections 402-407 and 409.** The above-mentioned error is further compounded by the trial judge's decision on objections 402 to 407 and 409. The documents in question that Defendants sought to introduce during cross-examination went directly to the credibility of the above testimony. The trial judge accepted that the exhibits in question were relevant, but refused to admit them on the basis that a competent witness had not legally produced them and that they therefore constituted hearsay. This is an error of law. These documents were admissible under the business records exception (2870 CCQ). Moreover, this judgment should be contrasted with the fact that in the same judgment (objections 453 and 456), the trial judge dismissed Defendants' objections as to Strassberg being permitted to identify the types of documents and books that he would have seen during the 1990 audit of DTS. The books and documents that were identified by Strassberg are the same types of documents as those the trial judge refused to allow Defendants to produce during cross-examination of Strassberg on the

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585 *Gémika* v. *Centre de la Petite Enfance Ste-Gertrude*, 2005, AZ-50337095 (C.S.), p. 12; *Rougeau* v. *Compagnie Fernand Goupil*, 2001 B.E.-639, para. 173; *Mac Pherson* v. *Canadian Javelin Ltd.*, [1982] R.C.S. 563, p. 10; *Champagne* v. *Champagne*, AZ-50081957 (C.Q.), p. 5; L. Ducharme, *Précis de la preuve*, 6th ed., Wilson et Lafleur, 2005, paras 1241-1243; J.C. Royer, *La preuve civile*, 4th ed., Éditions Yvon Blais, Cowansville 2008, paras 1244 and 1280 *in fine*.

basis that a "competent" witness had not produced them. This testimony establishes that the documents covered by objections 402 to 407 and 409 were in fact available to Strassberg for the 1990 audit. The trial judge should have concluded that Strassberg was competent to identify them and admitted them on that basis.

SECTION VI - APPEAL NO. 3 (MOTIONS)

A) QUESTION IN DISPUTE

Did the trial judge err in rejecting Defendants' Motion that sought to produce the proceedings and three (3) judgments of the Ontario Institute of Chartered Accountants concerning Whiting?

Defendants submit the trial judge erred in refusing to permit the introduction of the proceedings and judgments.

B) ARGUMENT

573. The argument to follow addresses the decision made in respect of the Motion to introduce disciplinary proceedings and three (3) judgments rendered by the Disciplinary and Appeal Committees of the Ontario Institute of Chartered Accountants ("OICA") in respect of Whiting.

574. Vance's assumption that Whiting would have given honest information to Castor (*supra*, para. 347) cannot be reconciled with three (3) decisions emanating from the OICA. These judgments concluded that Whiting provided false information to Castor and to C&L.

575. The trial judge refused to admit these judgments on the basis that: 1) Whiting was Defendants' witness and that, as such, Defendant could not impeach his credibility, and 2) that the judgments were posterior to Whiting's testimony and, as such, article 310 C.C.P. prevented Defendants from doing so (§§14, 15 of judgment no. 3).

576. This is manifest error of law.

577. Whiting was not Defendants' witness. Rather, by agreement of the parties, extracts from the testimony of Whiting from the first trial, during which he testified for over 40 days as a witness for the Plaintiff, were filed in the Court record.[586] The fact that Defendants initiated the process of filing the extracts does not change the fact that the evidence was admitted by the trial judge further to a consent agreement. This process does not alter the nature of the proof from the first trial that was adduced in the second trial by consent. Defendants may seek to impeach the credibility of Whiting and the exhibits that were filed through him.[587] The trial judge's reasoning, if adopted by this Court, means that Defendants may not invoke any of the extracts that were filed in order to impeach Whiting's credibility.

578. In addition, the filing by consent of exhibits from the first trial into the Court record for the second trial was predicated on Defendants' right to examine a competent witness in respect of the exhibits and Plaintiff's obligation to make that witness available.[588] The exhibits produced under this agreement included several for which Whiting was the relevant witness. Despite including him on its lists of witnesses for the second trial until as late as December 1, 2008, Plaintiff did not call Whiting.

579. The provisions of article 310 C.C.P. relied on by the trial judge do not apply. This is not a case of Whiting making a statement inconsistent with his testimony. Rather, this is a case of the witness being convicted by his Professional Order as a result of that testimony and the introduction of that conviction as evidence.

580. Further, the fact that Vance would assume that Whiting would have told the truth to C&L, and that he did not consider the OICA judgment dated May 25, 2007 holding that Whiting misled Castor and C&L, which was rendered prior to Vance's testimony and his report for the second trial, is directly relevant to an assessment of Vance's credibility and stated assumptions.

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586 *Procès-verbal*, Dec. 8, 2009, Annex A.

587 For example, extracts from the cross-examination of Whiting that were filed were for the express purpose of establishing that he signed a confirmation that he knew to be false.

588 *Procès-verbal* and Annex D Jan. 7, 2008.

PART IV – CONCLUSIONS

FOR ALL OF THESE REASONS, APPELLANTS RESPECTFULLY REQUEST THAT THIS HONOURABLE COURT :

WITH RESPECT TO APPEAL NO. 1

- *With respect to the interlocutory judgment dated February 27, 2008 by which the trial judge dismissed in part the* Requête amendée des défendeurs pour faire rejeter du dossier en tout ou en partie, certains rapports d'expert, *dated February 13, 2008:*

  MAINTAIN the appeal;

  GRANT the Defendants' Motion dated February 13, 2008 to the extent that it was not granted by the trial judge;

- *With respect to the interlocutory judgment dated March 4, 2008 by which the trial judge established a "read-in rule" with respect to expert reports:*

  MAINTAIN the appeal;

  DECLARE that the rule applied by the trial judge according to which an expert report filed into the Court record is deemed to form part of the evidence, without all the parties' consent, is null, void and of no effect;

- *With respect to the final judgment rendered on April 14, 2011:*

  MAINTAIN the appeal;

  DISMISS Plaintiff's action;

WITH RESPECT TO APPEAL NO. 2 (OBJECTIONS):

- ***With respect to objections #71, 80, 126, 127, 402-407 and 409:***

  DISMISS the objections and **PERMIT** the introduction of the exhibits and testimonies objected to.

- ***With respect to objections #88, 369-373, 454, 455, 457 and 461:***

  MAINTAIN the objections and **STRIKE** the exhibits and testimonies referred to from the record.

WITH RESPECT TO APPEAL NO. 3 (MOTIONS):

- ***With respect to the proceedings and judgments of the disciplinary and appeal committees of the Ontario Institute of Chartered Accountants:***

  GRANT the appeal and **PERMIT** the filing of the proceedings and judgments.

THE WHOLE with costs, including experts costs, in both Courts.

The whole respectfully submitted at Montreal,
this November 3, 2011

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Heenan Blaikie
(Yvan Bolduc, Ad. E.)
(M^e Serge Gaudet)
(M^e Gary S. Rosen)
Attorneys for Appellants

PART V – AUTHORITIES

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Jurisprudence *(cont'd)* **Paragraph(s)**

Doctrine *(cont'd)* **Paragraph(s)**