

FACULTY OF LAW, MCGILL UNIVERSITY

*ETHICS AND PROFESSIONAL LIABILITY:
FUNDAMENTAL ISSUES FACING ALL PRACTITIONERS*

May 9, 1997

**EXPOSURE OF THE
PROFESSIONAL WHO ACTS AS AN
EXPERT WITNESS**

by

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of

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Business Valuers/Chartered Accountants

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1.	INTRODUCTION	1
1.1	ACCOUNTANTS’ LITIGATION-SUPPORT SERVICES VS. ATTESTATION SERVICES	2
1.2	LITIGATION-SUPPORT SERVICES	2
1.3	LITIGATION-SUPPORT ENGAGEMENTS	4
1.4	TYPES OF LITIGATION SUPPORT SERVICES	5
2.	PROFESSIONAL STANDARDS	6
2.1	UNITED STATES EXPERIENCE	7
2.1.1	THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS	7
2.1.1.1	SPECIAL REPORT 93-1	9
2.1.1.2	SPECIAL REPORT 93-2	10
2.1.1.3	PRACTICE AID 93-4	10
2.1.2	THE INSTITUTE OF BUSINESS APPRAISERS, INC.	15
2.2	CANADIAN EXPERIENCE	15
2.2.1	THE CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS	15
2.2.2	THE CANADIAN INSTITUTE OF CHARTERED BUSINESS VALUATORS	17
3.	PROFESSIONAL MALPRACTICE SUITS AGAINST EXPERTS	18
3.1	UNITED STATES EXPERIENCE	19
3.1.1	THE BILY DECISION	20
3.1.2	THE CREDIT LYONNAIS BANK NEDERLAND N.V. DECISION	24
3.1.3	THE CS FIRST BOSTON INC. DECISION	27
3.1.4	THE MATTCO FORGE DECISION	29
3.2	SELECTED CANADIAN PROFESSIONAL LIABILITY CASES	35

3.2.1	THE ROMAN CORPORATION LTD. DECISION	36
3.2.2	THE BURGoyNE DECISION	37
3.2.3	THE WOLVERINE TUBE DECISION	41
4.	AUDITORS IN QUEBEC	42
5.	SUGGESTED WORDING FOR ENGAGEMENT LETTERS	49
6.	CONCLUSION	52

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1. INTRODUCTION

A *Los Angeles Times* article in 1994 contained the following opening paragraphs:

“A Los Angeles jury Tuesday ordered Ernst & Young to pay \$27.8 million in punitive damages to a Southland aerospace company that accused the accounting firm’s legal services practice of fraud and malpractice.

“The judgment, in addition to a previous \$14.2 million jury award against Ernst & Young for actual damages, may lead accounting firms to closely examine their fast-growing litigation support businesses.”¹

And in an article three weeks earlier, the *Los Angeles Times* claimed that “accounting firms are finding the going tricky in a business landscape heavily pocked with liability land mines ...”.

Few experiences in a professional’s practise provide the personal challenge and mental stimulation of expert witness testimony. The expert witness must present complex technical matters in a clear, logical and concise manner to a judge or arbitrator who might have little or no training in the relevant technical issues. Then, with no time for extensive reflection or consultation with others, the witness must defend

* Of Wise, Blackman, Business Valuers and Forensic Accountants.

(1) J. Sanchez, “Ernst & Young Ordered to Pay \$27.8 million for Malpractice”, *Los Angeles Times*, June 22, 1994, page 2, part D, column 5.

that testimony under the probing cross-examination of an often knowledgeable, well-briefed, hostile and aggressive interrogator. Large potential gains or losses X economic, personal and sometimes emotional X may be triggered from the outcome.

Testimony in court may comprise as little as 5-20% of the time on a litigation-support engagement. Many litigation-support engagements often do not even involve any expert testimony; most engagements which originally contemplate testimony are settled before the matter ever comes to trial. Nevertheless, trial testimony is the ultimate focus of most litigation-support services and it is the centre of litigation-support consulting.

1.1 Accountants' Litigation-Support Services vs. Attestation Services

The CA's role in litigation support is different from that in an audit engagement. In the latter, which is an *attestation* engagement, the CA expresses a conclusion as to the reliability of a written assertion of another party. In litigation support, the expert helps gather and interpret facts and will then support and defend the conclusions reached. The attestation standards of the accounting and auditing professions were established in order to provide assurance to third parties, whereas in litigation-support services, the CA is subject to the rules of the particular proceedings, including examination-for-discovery and cross-examination. There are a host of differences between attestation and litigation-support engagement, as my graphics demonstrate.

1.2 Litigation-Support Services

Litigation-support services include any professional assistance provided to legal counsel in the litigation process.² The primary litigation-support services include those of an expert engaged to act as a

(2) The accounting profession in the United States refers to such services as "the use of accounting and consulting skills to assist a client in a matter that involves pending or potential litigation or dispute resolution proceedings with a trier of fact".

consultant or witness at trial. In litigation support, a professional acting as an expert in a litigious matter will generally play a role as:

- (a) *Expert.* One who is qualified by knowledge, skill, experience, training or education in performing business valuation.
- (b) *Expert witness.* An expert who is engaged to express an expert opinion and to testify at trial. There is generally a restriction that the subject of the expert's opinion should be so distinctly related to some science, profession, business or occupation as to be beyond the knowledge of the average layperson. Therefore, expert evidence is permitted when technical, scientific or specialized knowledge will assist the court in understanding the evidence or in determining a fact that is in issue.
- (c) *Consulting expert.* An expert who is engaged to advise the lawyer or expert witness about technical matters related to the subject litigation, but who will not be called to testify at trial.

When an expert is engaged by counsel only as a consultant, a work-product privilege (solicitor-client privilege) protects the work performed for the lawyer and that work generally need not be disclosed to the opposing side. When a professional is engaged to testify as an expert witness, all work performed may be discoverable. The primary implication of this is that anything the expert witness has reduced to writing X even handwritten notes X may have to be turned over to the opposing side. Once the expert is engaged, a prompt understanding should be reached on the role to be played and what may be reduced to written form. Previous draft reports may be discoverable, depending on the provincial jurisdiction where the case is being tried.

An expert may be initially engaged as a consultant and then, later, designated as a testifying expert.³ When an expert is designated to testify at trial, all of the working papers and other documentation

(3) For a more detailed discussion of the different litigation-support functions that may be divided among different valuation experts, see Richard M. Wise, "Experts Now Play More Than One Role in Financial Litigation", *The Bottom Line* (Butterworths: October 1990).

related to that testimony becomes discoverable. If the expert believes that there is a significant possibility that he or she will be required to be examined or testify at trial, working papers should be prepared assuming that they will be subject to discovery. The expert should consult with the attorney concerning such items as correspondence, etc.

In some instances, the professional engaged may perform other services which are not directly related to his or her testimony. For example, an expert may provide assistance in preparing charts and graphs to be used in examining other witnesses. The working papers related to these other services may or may not be discoverable (depending on the nature thereof and/or the particular jurisdiction). In those situations, the expert will discuss the extent of the work-product privilege (solicitor-client privilege) with the client's lawyer.

The remaining contents in this paper will generally relate to Chartered Accountants who provide, or may end up providing, expert evidence on behalf of a client.

1.3 Litigation-Support Engagements

The variety of litigated cases requiring professional expertise from public accountants and business valuers is almost limitless.⁴ Some of the most common types of cases include:

- (a) Separation and divorce.
- (b) Partner/shareholder disputes.
- (c) Taxation and capital gains.
- (d) Economic damages X lost profits (breach of contract; extra-contractual).
- (e) Insurance claims X business interruption and disturbance.
- (f) Expropriation of business or property.

(4) See Richard M. Wise, *Financial Litigation — Quantifying Business Damages and Values*, Canadian Institute of Chartered Accountants (Toronto: Loose-leaf service).

- (g) Minority shareholder appraisal and oppression remedies.
- (h) Trespass and conversion.
- (i) Professional malpractice: Interpretation of accounting principles and professional performance.
- (j) Antitrust/unfair competition.
- (k) Intellectual-property infringement damages.

In addition, to a professional's litigation-related services as an expert witness, some professionals act as arbitrators or mediators in alternative dispute resolution.

1.4 Types of Litigation Support Services

Depending on the particular case, the expert can provide a broad variety of litigation-support services. Some of the most typical services include, in the case of a professional accountant:

- (a) Performing a preliminary evaluation of the case. (Often, the expert's initial engagement is to evaluate the quantum-related merits of a potential case. Performing a preliminary evaluation can help the client's legal counsel decide the direction of the case. However, the level of work performed at the preliminary level is normally not sufficient to provide an opinion as to quantum.)
- (b) Performing a valuation review. (Reviewing an appraisal or damages report can help the client's counsel assess the validity of the conclusion and help shape the strategy of the case. It is common for the expert to be asked to review the opposing expert's report prepared on behalf of the opposing party.)
- (c) Preparing a list of information to be gathered during the discovery process.
- (d) Consulting with counsel regarding arbitration or mediation as an alternative to litigation.

- (e) Preparing or reviewing suggested interrogatory and/or discovery questions.
- (f) Preparing or reviewing preliminary valuation or damage calculations for settlement purposes.
- (g) Researching relevant case law, financial literature and other authoritative resources, from an accountant's or a valuation perspective.
- (h) Assisting in the evaluation of settlement proposals or "fight/settle" decisions.
- (i) Providing out-of-court evidence (examination-on-discovery and/or examination-on-affidavit) and trial testimony.

One accounting or valuation expert may perform any or all of these services. However, if the case is significant enough, the litigation-support functions may, as noted above, be split between or among two or more experts (either within the same firm or from different firms). For example, a client's lawyer may use one expert to present direct testimony regarding the value of, or damages to, a business interest and a different expert to provide rebuttal (counter-proof) testimony and assistance in cross-examining the opposing expert. Such an approach may be helpful in removing a possible taint of advocacy from the team's primary expert. This approach may also be used when counsel wishes to find a rebuttal expert with experience and credentials which match or exceed those of the opposing expert. As noted above, there can also be three experts in the same field, but each playing a different role.⁵

2. PROFESSIONAL STANDARDS

Most litigation-support related standards and pronouncements have emanated from the public accounting profession in the United States. However, they clearly provide informal guidance to Canadian practitioners. It accordingly may be useful to briefly review these developments south of the border.

(5) Footnote 3, *supra*.

2.1 United States Experience

2.1.1 *The American Institute of Certified Public Accountants*

Litigation services are recognized as a management consulting transaction service in the Statement on Standards for Consulting Services (“SSCS”) issued by the AICPA and are defined in Consulting Services Practice Aid No. 93-4, *Providing Litigation Services* (New York: AICPA, 1993) as “any professional assistance non-lawyers provide to lawyers in the litigation process”.

Authoritative publications of the American Institute of Certified Public Accountants (“AICPA”) address litigation services only through the process of exempting these services from the attestation standard. Second 9100.48 of *Attestation Engagements Interpretations*, “Applicability of Attestation Standards to Litigation Services”, excludes litigation services which “involve pending or potential formal legal or regulatory proceedings before a trier of fact in connection with the resolution of a dispute between two or more parties ...”.

The Accounting and Review Services Committee of the AICPA states in an interpretation that Statements on Standards for Accounting Review Services generally do not apply to litigation-support engagements or when the litigation services are rendered in connection with the resolution of disputes between parties involved in pending or potential formal legal or regulatory proceedings before a trier of fact and when one of the following occurs: (a) the accountants are serving as expert witnesses; (b) the accountants are the triers of fact or acting on behalf of them; (c) the accountants’ work under the rules of the proceedings is subject to challenge and detailed analysis by all parties to the dispute; (d) the accountants are engaged by an attorney to do work that is protected under the attorney’s work product privilege and not to be used for any other purpose.

In the U.S., litigation-support engagements are generally subject to the Management Consulting Services Standards and exempt from the other standards promulgated by the AICPA. “Transaction

services”, as referred to in the definition of “litigation services” above, include, *inter alia*, business valuation, insolvency, merger and acquisition analyses, *litigation support*, and so forth.⁶

The SSCS require that the CPA comply with the general standards of the profession as promulgated in Rule 201 of the Code of Professional Conduct; these relate to professional competence, due professional care, planning and supervision and sufficient relevant data to afford a reasonable basis for conclusions and recommendations.

Therefore the general standards of professional competence, due professional care, planning and supervision, and obtaining sufficient relevant data apply to any professional services a professional accountant or business valuator performs.

In the United States, Interpretation 102-6, “Professional services involving client advocacy”, discusses the rules which apply to engagements in which a CPA acts an advocate for a client. This does not apply to litigation-support services. In fact, Ethics Ruling 101, “Client Advocacy and Expert Witness Services”, confirms that expert witness services do not constitute situations in which a CPA acts as an advocate for a client.

The attestation standards which Chartered Accountants must follow apply to a written conclusion concerning the reliability of a written assertion made by another party. However, in litigation-support services, the CA is making the assertion.

The AICPA provides its members with a host of consulting services publications. These include Technical Consulting Practice Aids, Small Business Consulting Practice Aids, Industry Consulting Practice Aids and Special Reports. The AICPA has already released four publications relating to litigation-support services performed by its members:

- *Application of AICPA Professional Standards in the Performance of Litigation Services* (Special Report 93-1)
- *Conflicts of Interest in Litigation Services Engagements* (Special Report 93-2)

(6) For example, see AICPA Professional Standards, CS section 100.05(d).

- *Providing Litigation Services* (Technical Consulting Practice Aid 93-4)
- *Communicating Understandings in Litigation Services: Engagement Letters* (Consulting Services Practice Aid 95-2).

The Institute has a standing Litigation Services Subcommittee (formed by the Executive Committee of the Management Consulting Services Division), established to assist in setting standards for, and to provide advice and guidance to, CPAs who provide litigation-support services. It also monitors other standards promulgated by AICPA bodies which may have an impact on litigation services.

2.1.1.1 Special Report 93-1

This special report, *Application of AICPA Professional Standards in the Performance of Litigation Services*, refers to “litigation services”, of a CPA as the use of accounting and consulting skills to assist a client in a matter that involves pending or potential litigation or dispute resolution proceedings with a trier of fact. Such services may include fact-finding (including assistance in the discovery and analysis of data), damage calculations, document management, expert testimony and other professional services required by the client or counsel.

Special Report 93-1 contains a listing of “typical litigation services engagements and their products and services” which includes acting in the role of, among other things:

- an expert witness before a trier of fact
- a consulting expert to an attorney (rather than a testifying expert)
- an arbitrator
- a court-appointed expert (as an arm of the court).

The possible products or services include:

- computation of economic damages
- professional standards analyses
- business valuations
- fraud identification
- divorce
- bankruptcy
- forensic accounting
- insurance claims.

Special Report 93-1 also discusses professional standards applicable to litigation services and outlines the relationship of attestation and other professional standards to litigation services.

2.1.1.2 Special Report 93-2

This AICPA release addresses professional issues in litigation services, in particular the need to maintain integrity and objectivity and the concept of independence. It identifies conflict issues for CPAs, distinguishing the professional responsibilities as between professional accountants and attorneys. Special Report 93-2 contains examples of potential conflicts of interest and includes a “conflict of interest decision tree”.

2.1.1.3 Practice Aid 93-4

Technical Consulting Practice Aid 93-4, *Providing Litigation Services*, while not establishing standards or preferred practices, defines and explains the American CPA’s function in the civil litigation process. It focuses on the issue of damages (out-of-pocket losses and claims for lost profits) in cases where the CPA is retained by the plaintiff to calculate damages or, on the other hand, is retained by the defendant to study and rebut the plaintiff’s damage computation. While Practice Aid 93-4 recognizes that accountants work predominantly in civil litigation matters (which is the subject matter addressed in

the publication), it notes that criminal cases may also require similar services (e.g., tax evasion, price fixing, etc.) and that the comments apply equally to the professional accountant's supporting role in criminal litigation.

Providing Litigation Services also distinguishes between the practitioner who is not called upon to testify about his or her opinion, and the expert witness, on the other hand, who is retained to render an expert opinion at trial.⁷ These differences can be crucial, particularly when it comes to solicitor-client privilege, discovery of documents, examination of the expert, etc.

Practice Aid 93-4 provides an extensive listing of services which CPAs provide to lawyers in the litigation process, categorizing the types of litigation support engagements in which the accounting expert provides advice and assistance to counsel. For example, under the broad heading, "damages", the following subcategories are listed:

- Lost profits
- Lost value
- Extra cost
- Lost cash flow
- Lost revenue
- Mitigation.

Items enumerated under the category of "accounting" comprise:

- Auditors' or accountants' malpractice
- Bankruptcy and reorganization
- Family law
- Tracing
- Contract cost and claims

(7) *Ibid.*

- Regulated industries
- Frauds, civil and criminal
- Historical analyses.

Practice Aid 93-4 focuses on economic damages. This subject matter is divided as follows:

- Proving the cause of damages
- Proving the amount of damages (once the cause of damages has been established)
- Determining the economic, statistical or commercial facts to support liability arguments
- Assisting in criminal litigation (e.g., tax evasion and other types of fraud)
- Developing automated document-retrieval systems
- Providing bankruptcy and reorganization services, including determination of solvency of the debtor and analysis of prospective financial information.

Included is a comprehensive and key section on engagement acceptance considerations, including the role of the professional accountant, the practitioner-client relationship, conflicts of interest (referring to Special Report 93-2, *Conflicts of Interest in Litigation Services Engagements*). As regards the practitioner-client relationship, a distinction is made between the client who is one of the parties to the litigation (e.g., plaintiff or defendant) and the attorney.

Providing Litigation Services comments on timetables, fees, staffing, merit and inconsistent opinions. There is also a section on engagement objectives and client benefits.

The commentary relating to scope of the engagement addresses such matters as changeable environment (e.g., where the focus of the litigation may shift because of the discovery of additional facts, the winning or losing of legal motions prior to trial, or merely a better understanding of the real facts at issue, and the modification of the accountant's role and methodology as a result thereof). Lack of familiarity with data is also commented upon.

The Practice Aid outlines counsel's role and discusses the following roles of the accountant who provides litigation-support services:

- Acting as either consultant or expert witness;
- Preparing or rebutting studies;
- Engagement letters;
- Documentation; and
- Professional standards.

Practice Aid 93-4 contains a section entitled "Engagement Approach", which discusses the methodologies which are typically applied to compute lost profits.

Services outlined include:

- Assistance with discovery, including interrogatories, requests for production of documents and examinations-for-discovery (either giving discovery evidence or assisting counsel in examining the opposing side);
- Subpoenas (assisting counsel by preparing a "shopping list" of documents and information to be requested pursuant to a subpoena *duces tecum*);
- Requests for admissions; and
- Other discovery issues.

Analysis is referred to as "the best use of the CPA's expertise" and involves the making of assumptions and performing of calculations to arrive at an opinion and prepare testimony. With respect to financial projections in calculating lost profits, the Practice Aid comments as follows:

- "31 The CPA's work for the plaintiff in a litigation services engagement very often involves creating financial projections for a lost-profits damages study. Obviously such a task entails a significant degree of uncertainty because it projects profits the plaintiff would have earned over some time period if the defendant had not interfered in some manner. Over the years the federal

courts have come to recognize the difficulties plaintiffs face in damages studies and, in many cases, have accepted the concept that once the fact of damages is proven, the amount of damages may be proven with much less certainty and precision. The courts have reasoned that the defendant should not benefit from the very activities that the plaintiff alleges not only caused the damages, but also made it difficult to calculate. Thus, experts are generally given significant latitude in proving the amount of damages as long as they use reasonable assumptions and the best information available in constructing the damages estimate.”

Analysis includes:

- Defining relevant markets and computing market share;
- Restating or reconstructing financial records;
- Calculating actual losses;
- Developing profit and cost relationships;
- Developing pro forma financial statements;
- Preparing but-for lost-profits models, etc.

Practice Aid 93-4 contains commentary on the expert opinion of the CPA, use of staff and presentation of results. This last category is subdivided among overall testimony by the expert witness, written reports by the expert witness, written or oral reports by the consultant, exhibits (schedules, graphics, flow charts, etc.), affidavits, declarations and working papers.

Finally, there is a section entitled “Effective Testimony Techniques”, making suggestions as to the expert’s demeanour in or near the courtroom, examination-in-chief, structure of typical direct testimony, cross-examination by opposing counsel and visual aids.⁸

AICPA Practice Aid 93-4 includes two sample engagement letters for litigation-support mandates. The following optional paragraph is included where the engagement letter is with a law firm:

(8) For an in-depth discussion of preparing for, and presenting, expert evidence as an accountant, business valuator or financial analyst, see R.M. Wise, *Financial Litigation — Quantifying Business Damages and Values*, The Canadian Institute of Chartered Accountants, Toronto (loose-leaf service).

You or your law firm or the court itself will advise us (with sufficient notice) of the work to be performed by us and the requirement for appearance in court. If there is a substitution or change in the association of attorneys involved in this litigation, we reserve the right to withdraw from this engagement.

Practice Aid 93-4 concludes with a case study relating to a dispute involving damages for lost profits. The case study includes a sample request for production of documents as well as sample examination-for-discovery/cross-examination questions.

2.1.2 *The Institute of Business Appraisers, Inc.*

This U.S.-based professional society has promulgated Standard Three, “Expert Testimony”. Paragraph 3.1 defines expert testimony as “an oral report given in the form of testimony in a deposition and/or on the witness stand before a court of proper jurisdiction or other trier of fact.” Paragraph 3.2 thereof reads as follows:

3.2 Mandatory Content. The appraiser shall answer all questions put to him in a manner that is clear and not misleading. When giving testimony, the appraiser shall not advocate any position that is incompatible with the appraiser's obligation of non-advocacy, i.e., it is unethical for the appraiser to suppress any facts, data, or opinions which are adverse to the case his client is trying to establish, or to over-emphasize any facts, data, or opinions which are favorable to his client's case, or in any other particulars become an advocate. ...”.

2.2 Canadian Experience

2.2.1 *The Canadian Institute of Chartered Accountants*

In Canada, The Canadian Institute of Chartered Accountants’ Investigative and Forensic Accounting Interest Group (“IFA IG”) has a Subcommittee for Technical Bulletins, which has been considering issuing CICA publications similar to the AICPA Practice Aids outline above. The proposed CICA publications would not simply be “Canadianized” versions of the AICPA Practice Aids; rather, they

would address additional relevant and practical issues confronting Canadian CAs who practise in the field of forensic and investigative accounting as well as in other litigation-support areas, including business valuation and damages quantification. The IFA IG Leadership Committee was also reviewing recommendations for possible inclusion in the *CICA Handbook* and considering suggestions for the most appropriate means for the CICA — through the IFA IG — to issue technical and practice issue bulletins (guidance) relative to forensic accounting services conducted by CAs. The CICA's *An Introduction to Investigative and Forensic Accounting Issues*⁹, is an example.

On another front, the Canadian chapter of the Association of Certified Fraud Examiners, a Texas-based group of accredited professionals which grants the designation "Certified Fraud Examiner", encourages its members in the preparation of quality reports and the use of professionalism in conducting oneself in court. The Canadian chapter of the CFEs, mainly professional accountants, also holds seminars which include expert-witness preparation, investigative techniques and other subjects of interest to accountants and others working in fraud prevention and detection.

With four AICPA litigation-related publications issued in the U.S. to date, and noting the active role in Canada played by the CICA Leadership Committee of the IFA IG via its publication, *The Balance Sheet*; the annual IFA IG conferences; and publishing of Practice Aid 95-1, *An Introduction to Investigative and Forensic Accounting Practice Issues*, the increasing importance of litigation-support to professional accountants is obvious.

Practice Aid 95-1 was drafted in order to provide educational and reference material for members of the IFA IG and other Chartered Accountants interested in the practise of investigative and forensic accounting. It does not establish standards or preferred practises. While this documents provides an overview, it is intended that it would be supplemented by further Practice Aids which would deal with selected topics in greater depth.

While litigation-support services do not specifically fall within the scope of the *CICA Handbook*, certain general standards promulgated by the provincial Institutes/Ordre may be applicable to these services,

(9) Practice Aid 95-1, co-authored by G.B. McInnis, D.M. Crane, I. Gottschalk and R.M. Wise (CICA: 1995).

particularly those dealing in the areas of professional competence, independence and objectivity, due professional care, planning and the supervision of assistants — similar to what was outlined earlier *vis-à-vis* the AICPA in the United States.

In short, Chartered Accountants should undertake only those engagements which they can reasonably expect to complete with professional competence. Professional competence includes having the required education and experience to complete a particular engagement. The CA should therefore discuss his or her particular qualifications with the client and counsel before undertaking a particular engagement.

2.2.2 *The Canadian Institute of Chartered Business Valuators*

The Canadian Institute of Chartered Business Valuators, comprising over 90% Chartered Accountants by training, has not only promulgated various standards with respect to business valuations, but also specifically relating to litigation-support services:

- Standard 310, *Expert Reports — Report Disclosure Standards and Recommendations*, was issued with respect to members retained as experts to provide their professional opinion as to damages or the quantum of financial gain or loss in connection with, for example, claims arising from financial disputes such as personal injury matters, alleged breach of contract, patent infringement or other similar claims.¹⁰
- Standard 320, *Expert Reports — Scope of Work Standards and Recommendations*, setting out the minimum procedures to be performed, as well as those recommended.
- Standard 330, *Expert Reports — File Documentation Standards and Recommendations*, relates to the minimum file documentation which must be included for purposes of the relevant expert report, as well as recommendations.

(10) The standards define “expert report” as “any written communication other than a Valuation Report, on letterhead and/or where the author(s) is identified, containing a conclusion as to damages or the quantum of financial gain/loss prepared by a Valuator acting independently and that is not clearly marked as being in draft form”.

Chartered Business Valuators are required by their Code of Ethics (Rule 203.2) to be “competent, conscientious, knowledgeable, diligent and efficient”. Section 204 is more specific:

“A Member or Registered Student shall not undertake to provide professional services which he (she) is not competent to provide by virtue of training or experience or as unable to become competent without undue delay, risk or expense to the client.”

3. PROFESSIONAL MALPRACTICE SUITS AGAINST EXPERTS

Chartered Accountants and certain other professionals (e.g., actuaries) who render “litigation-support” services are being sued with increasing frequency, because they make particularly good targets for malpractice litigation:

- (a) There are often a number of assumptions made (or accepted) by the professional;
- (b) There are predictions, forecasts and projections made;
- (c) There may be complex mathematical and financial calculations performed;
- (d) There may be large dollar amounts involved;
- (e) There are an increased number of parties who may be affected.

It is particularly instructive to refer to developments in the United States, as these relate to public accountants who render professional opinions other than pure audit opinions. These include, for example:

- business valuation opinions;
- solvency opinions;
- fairness opinions;

- financial-viability opinions;
- opinions as to economic damages, etc.

3.1 United States Experience

In the United States, the “traditional rule” on professional negligence liability emanates from the New York Court of Appeals watershed opinion in *Ultramares Corp. v. Touche*¹¹, i.e., that professionals could only be sued by clients or individuals in a client-like relationship. Since that decision, the U.S. courts have recognized the potentially enormous liability facing professionals rendering opinions concerning large transactions, and have attempted to develop professional negligence rules to ameliorate that possibility. They have done so primarily under the rubric of two legal doctrines: (a) the concept of “duty” in negligence cases, and (b) the concept of “justifiable reliance” in fraud cases.

Where “direct communications” and “personal meetings” between the professional and a third party create “a nexus between them sufficiently approaching privity”, negligence liability attaches.¹² Even though a professional may be aware of potential third-party recipients of his or her opinion so as to receive notice of the specific risk accompanying the engagement, there is no liability. Rather, there must be further distinct conduct “linking” the auditor to the third party who provides the professional with an “understanding” of third-party reliance.¹³

As the Court stated in *Credit Alliance v. Arthur Andersen & Co.*:

Before accountants may be held liable in negligence to non-contractual parties who rely to their detriment on inaccurate financial reports, certain prerequisites must be satisfied: (1) the accountant must have been aware that the financial reports were to be used for a particular purpose or purposes; (2) in the furtherance of which a known party or parties was intended to rely; and (3) there must have been some conduct on the part of the accountants linking them to that party or parties, which evinces the accountants’ understanding of that party or parties’ reliance. (At page 118.)

(11) 255 NY 170, 174.

(12) *Credit Alliance v. Arthur Andersen & Co.*, 483 NE 2d 110 (1985).

(13) At page 120.

In some of the states, the foreseeability approach to professional negligence liability is endorsed, i.e., a professional's duty extends to all reasonably foreseeable users of the opinion. Based on the decision in *Rosenblum v. Adler*¹⁴, a New Jersey case, an auditor, for example, would owe a duty not only to the client, but also to "all those whom that auditor should reasonably foresee as recipients from the company of the statements for its proper business purposes, provided that the recipients rely on the statements pursuant to those business purposes".¹⁵

The following cases are intended merely to make practitioners aware of the high degree of due diligence which must at all times be exercised no matter what type of engagement is accepted. The comments are not intended, in any manner whatsoever, to represent a legal commentary or opinion on the respective matters, but rather, to highlight the kinds of issues that are critical to the professional. Needless to say, the rules and precedents may differ from jurisdiction to jurisdiction; practitioners in Quebec, in particular, should also consider the following cases as merely providing strong guidance and powerful caveats for those who act, or wish to act, as expert witnesses.

3.1.1 *The Bily Decision*

In *Bily v. Arthur Young & Co.*, the California Supreme Court held that professionals owe a duty of care only to their clients on whose behalf they issue opinions. Moreover, the professional's liability for negligent misrepresentation in connection with an opinion extends only to its intended recipients.

As background, in 1983, Arthur Young had issued unqualified audit opinions on Osborne Computer Corp.'s 1981 and 1982 financial statements, and addressed these audit reports to the company. Shortly after the issuance of the audit reports, Osborne's financial condition began to deteriorate, culminating in the company's bankruptcy. Plaintiffs, who were investors in the company, filed suit against Arthur Young for negligence and negligent misrepresentation, claiming that they made their investments in the company in reliance on the Arthur Young audit reports. A jury returned a verdict

(14) 93 NJ 324; 461 A. 2d 138 (1983).

(15) At page 153.

against Arthur Young, which the California Court of Appeal affirmed. The California Supreme Court, however, reversed, in a significant ruling holding that “an auditor’s liability for general negligence in the conduct of an audit of its client’s financial statements is confined to the client, i.e., the person who contracts for or engages the audit services. Other persons may not recover on a pure negligence theory”.¹⁶

However, the *Bily* decision is not limited to audit reports. As the California Supreme Court expressly stated in that case:

[A]ccountants are not unique in their position as suppliers of information and evaluations for the use and benefit of others. Other professionals ... also perform that function. And, like auditors, these professionals may also face suits by third persons claiming reliance on information and opinions generated in a professional capacity.¹⁷

Bily’s treatment of the doctrine of justifiable reliance in fraud cases was cited and extended in *Resolution Trust Corp. v. Roe*¹⁸ which involved a Compilation Report (the U.S. equivalent of a Notice to Reader in Canada) containing financial information based on the “representation(s) of the individuals whose financial statements are presented”.¹⁹ In addition, the Compilation Report specifically disclaimed responsibility for the accuracy of the financial information it presented:

(16) At page 406.

(17) At page 410. Subsequent decisions have applied the *Bily* rule to other professional opinions. See, for example, *Lincoln Alameda Creek v. Cooper Industries, Inc.*, 829 F.Supp. 325 (N.D. Cal. 1992).

(18) 1993 WL 165303 (N.D. Cal. 1993).

(19) At page 1.

“We have not audited or reviewed the accompanying statement of financial condition and, accordingly, do not express an opinion or any other form of assurance on it.”²⁰

The Court held that this limiting language rendered the plaintiff-lenders’ alleged reliance on the compilation report to extend a U.S. \$3.5 million loan unreasonable as a matter of law. The defendant’s statement that it had not independently verified the financial information it received was, in the words of the Court, “more than sufficient to put a reasonably prudent lender on notice that [such information] should be verified by the lender”.²¹

Accordingly, “[g]iven the amount of the loan, the sophistication of the lender, and the disclaimers contained in the [report], ... *no rational lender could have relied upon the [report] in making its loan decision*”.²² (Emphasis added.)

Bily is founded upon the assumption that it is better policy to require that investors and lenders perform their own due diligence and, where necessary, hire their own consultants or other professionals to assess the risks associated with a particular lending or investment decision. For such reason, *Bily* unequivocally proscribes “blind faith” in professional opinions, considering such behaviour itself conclusive evidence of unreasonable reliance:

If a third party possesses sufficient financial sophistication to understand and appreciate the contents of audit reports ... he or she should also be aware of their limitations and of the alternative ways of privately ordering the relevant risks. If, on the other hand, a third party lacks the threshold knowledge to understand the audit report and its terms, *he or she has no reasonable basis for reliance*. (Emphasis added.)²³

(20) In Canada, the analogous wording is: “We have not audited, reviewed or otherwise attempted to verify the accuracy or completeness of such information [provided by management and from which the financial statements were compiled]. Readers are cautioned that these statements may not be appropriate for their purposes.”

(21) At pages 2, 3.

(22) At page 3.

(23) At pages 403, 404.

Hence, an investor or lender cannot claim that he or she lacks the sophistication to independently review and analyze a professional opinion, and at the same time claim that he/she reasonably relied on the opinion.

The considerations underlying the *Bily* decision in California militate strongly in favour of applying the *Bily* rule to most professional opinions, including business valuations, fairness opinions, damages opinions and other opinions of experts. First, like Auditors' Reports and Notices to Reader, most professional opinions are based upon information provided by the client. However, unlike audit reports (which are based on verifiable historical data), valuations and damage quantification opinions are often based on information incapable of verification, e.g., the cash flow projections and business plan provided by the client. Anyone sophisticated enough to properly use and evaluate a financial opinion based on such input should likely be aware of its inherent limitations.

In addition, like the auditors in *Bily*, most accountants and business valuers who render professional opinions have no unusual expertise in, or control over, the products or services of their clients or their markets. Accordingly, as the court in *Bily* noted, "reasonable and prudent ... lenders will dig far deeper in their 'due diligence' investigations than the surface level of [a professional] opinion".²⁴

A lender or investor can (and usually will) independently examine a borrower's or investee's financial information, or otherwise verify the assumptions upon which a professional opinion is based. Furthermore, a lender or investor can commission its own opinion, appraisal or other financial analysis, as it considers appropriate in the circumstances. Finally, a lender or investor can request permission to rely on an opinion or appraisal commissioned by its borrower or investee in return for appropriate consideration, thereby establishing privity of contract between itself and the professional rendering the opinion, to whom it could then look for protection. As the court observed in *Bily*:

[A] third party might expend its own resources to verify the client's financial statements or selected portions of them that were particularly material to its transaction with the client. Or it might commission its own audit or investigation, thus establishing privity ...
. As a matter of economic and social policy, *third parties should be encouraged to rely*

(24) At pages 400 and 401.

*on their own prudence, diligence and contracting power, as well as other informational tools. This kind of self-reliance promotes sound investment and credit practices and discourages the careless use of monetary resources. (Emphasis added.)*²⁵

Hence, California and several other jurisdictions south of the border require lenders and investors to take such reasonable steps to protect themselves. If they do not, a professional, in effect, becomes an “insurer” of the financial information provided by its clients and a guarantor of bad loans and investments generally.

Finally, as in the audit context, there is no likelihood that extending negligence claims to third parties will deter mistakes, promote more careful professional opinions or more efficiently spread risk. “In light of the relationship between [the supplier of information], client and third party, and the relative sophistication of third parties who [allegedly] lend ... based on [professional opinions], it might also be doubted whether [professional firms] are the most efficient absorbers of the losses from inaccuracies in financial information”.²⁶

3.1.2 The Credit Lyonnais Bank Nederland N.V. Decision

In late 1992, Credit Lyonnais Bank Nederland N.V. (the “Bank”) filed a U.S. \$500 million lawsuit in Los Angeles Superior Court against Houlihan, Lokey, Howard & Zukin Inc. (“HLHZ”), a nationally recognized financial advisory firm in the U.S. specializing in business valuations, fairness opinions and solvency matters; Kirk Kerkorian and his holding company (through which Kerkorian owned MGM/United Artists); two former MGM/UA officers and Giancarlo Parretti. The complaint alleged, *inter alia*, that a “solvency opinion” issued by HLHZ falsely represented — either intentionally or negligently — that MGM would be financially solvent following the merger and would have sufficient operating cash flow to fund its future operations. The Bank allegedly relied on the solvency opinion in

(25) At page 403. In *Lincoln Alameda Creek v. Cooper Industries Inc. (supra)*, the “[plaintiff] could have hired her own environmental consultant to prepare a contamination report for her use. A broad rule of liability is of dubious benefit when an efficient means of self-protection is available”.

(26) At page 405.

advancing hundreds of millions of dollars toward the purchase price in the form of loans and the factoring of receivables. It further alleged that, contrary to HLHZ's representations in the solvency opinion, post-merger MGM experienced a working-capital shortfall of over U.S. \$250 million and that the Bank was required to advance MGM billions of dollars over the next few years simply to protect its merger-related loans.

The threshold issue in the Bank's claim for negligence against HLHZ was whether — the Bank being neither an addressee nor a recipient of the solvency opinion — there was a legal duty such that there could be a recovery for negligence. To prevail on its fraud and negligent misrepresentation claims, the Bank had to establish, among other things, that it justifiably relied on HLHZ's solvency opinion.

In early 1994, the defendant made a motion for the court to summarily adjudicate in its favour all of the Bank's causes of action against it: negligence, negligent misrepresentations, fraud and two civil complicity claims. Shortly thereafter, a retired judge of the Los Angeles Superior Court, sitting as a law and motion referee, recommended that defendant's motion be granted in its entirety. The referee expressly noted that professional-negligence plaintiffs (typically business lenders and investors) are unique because of their relative sophistication and their ability to contractually control and adjust the risks associated with their undertakings. The referee applied *Bily* to the facts of this case and determined that, because there was no privity of contract between the Bank and HLHZ, the former's negligence claim failed as a matter of law.

Moreover, the referee cited a disclaimer contained in HLHZ's solvency opinion, *viz.*, that the firm had not expressed any intention to benefit the Bank, as would be required for the Bank to sustain its claim for negligent misrepresentation:

This Opinion is furnished solely for your benefit and may not be relied upon by any other person without our express prior written consent. This Opinion is delivered to each recipient subject to the conditions, scope of engagement, limitations and understandings set forth in this Opinion.

The referee noted that the Bank had never requested permission to rely on the solvency opinion, had never requested a copy of the solvency opinion and had not otherwise expressed any intention to rely on it, concluding that the defendant lacked notice of the Bank's intention to use the solvency opinion for "purposes of [its] credit analysis and decision-making involving loans of hundreds of millions to finance the merger." Thus, contrary to the rules expressed in *Bily*, HLHZ was deprived both of (a) notice of the risks associated with the undertaking and (b) the opportunity of assessing those risks.

The referee also concluded that, given the Bank's admitted action and inaction with respect to the funding of the merger, its alleged reliance on the solvency opinion was unjustified as a matter of law, the Bank's fraud claim therefore failing. The referee directly analogized the Bank's position to that of the lender in the *Resolution Trust* case (*supra*) and concluded that given the amounts of the Bank's loans, its sophistication, and the disclaimers contained in the solvency opinion, it was unreasonable for it to rely upon HLHZ's opinion in making its lending decisions.

Nor was the referee persuaded by the Bank's contention that HLHZ was the "expert", thereby entitling the Bank to rely on the conclusions contained in the solvency opinion without independently verifying them, rejecting this argument on two principal grounds:

- (a) Citing well-established California law, including *Bily*, the referee noted that courts proscribe ignorant reliance on alleged misrepresentations in the support of fraud claims:

The *Bily* case itself stated that professed 'blind faith' in an opinion is evidence of unreasonable reliance, that is if a party possesses sufficient sophistication to appreciate the contents of an audit report, they should be aware of their limitations and of the alternative ways of privately ordering the relevant risks. If a third party lacks the knowledge to understand the audit report, they have no reasonable basis for reliance.

- (b) Noting that a solvency opinion is not an audit, but rather a professional opinion or prediction as to *future* events, its users should be restricted to those on whose projections HLHZ relied in preparing its solvency opinion, namely MGM/UA and Pathé Communications Corporation.

Accordingly, the referee held that it was “unreasonable as a matter of law for [the Bank] to rely on an opinion given by a firm hired by its clients ... to satisfy a demand by MGM Directors” for a purpose different from the Bank’s lending decisions. Los Angeles Superior Court Judge Richard C. Hubbell adopted the referee’s recommendation.

3.1.3 *The CS First Boston Inc. Decision*

Despite the significant judicial strides in the United States toward limiting professional liability, legal threats to information-suppliers still exist, as a 1995 New York arbitration decision confirms.

Fairness opinions are critical components of financial transactions. A fairness opinion was rendered by CS First Boston Inc. (“First Boston”) on behalf of Medical Care International, Inc. (“MCI”) with respect to its merger with Critical Care America, Inc. (“CCA”) into Medical Care America, Inc. (“MCA”). It concluded that the consideration to be received by the MCI shareholders was fair from a financial point of view.

A share-for-share exchange ratio was based on the respective average closing market prices for the 60 trading days ended June 12, 1992 (prior to the merger announcement on June 17, 1992). Shareholders of MCI would receive one share of MCA for each share held and shareholders of CCA would receive 0.72 shares for each share held. Shares of both MCI and CCA were traded on the NYSE.

In addition to the fairness opinion rendered by First Boston for MCI, the investment banking firm of Alex. Brown & Sons rendered a fairness opinion for CCA. The Proxy Statement and Prospectus described the various valuation analyses performed by each firm. Each of the opinions used language similar to that in the First Boston opinion:

With respect to the financial forecasts, we have assumed that they have been reasonably prepared on bases reflecting the best currently available estimates and judgments of the Company’s and Critical Care’s management as to the future financial performance of the Company and Critical Care. In addition, we have not made an in-

dependent evaluation or appraisal of any of the assets of the Company or Critical Care, nor have we been furnished with any such appraisals.

A description in the Proxy Statement/Prospectus of the analyses performed by First Boston with respect to its discounted cash flow analyses indicated that variance of management's forecasts had been considered.

However, two weeks following the shareholder vote on the merger, MCA announced that earnings for the quarter ending September 30, 1992 would be well below analysts' expectations (454 versus 554 to 574), the shortfall arising from the home infusion therapy segment (provided by CCA's side of the merged operation). The share price of MCA's stock immediately fell from \$58 to \$25 before trading was halted.

A number of shareholder lawsuits were filed and in September 1993 a U.S. \$13,000,000 claim was filed by a group of doctors under the NYSE arbitration procedures. The New York Stock Exchange's arbitration procedures permit a shareholder to bring an action directly against any exchange member (or its employee), other than in a class action. The doctors alleged that First Boston "violated Section 11 of the U.S. *Securities Act of 1933* by opining that the consideration to be received in the merger was fair, when First Boston knew, or with due diligence should have known, that the merger consideration was unfair from a financial point of view".

Section 11 provides, *inter alia*, that:

... any person acquiring such security ... may, either at law or in equity, in any court of competent jurisdiction, sue ... every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or is having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report or valuation, which purports have been prepared or certified by him

The doctors alleged that First Boston prepared a faulty fairness opinion by not performing independent analyses of financial statements and projections provided by CCA's management; had they been performed, they would not have overvalued CCA in the transaction and MCI shareholders would have received more shares. The proceedings claimed that had First Boston conducted "even a minimal investigation of the financial statements and projections provided to it by [CCA's] management rather than blindly relying on them, it would not have been able to issue the fairness opinion sent to the claimants, and the merger would never have been approved".

The analyses performed by First Boston, and contained in the Proxy/Prospectus, arrived at exchange ratios of (a) 0.64 to 0.65 based on a discounted cash flow analysis, (b) 0.77 to 0.80 applying the guideline company method and (c) 0.77 to 0.79 based on comparable acquisitions. Other analyses were also performed by the firm but the resulting share values were not disclosed.

The NYSE arbitration panel awarded the claimants \$4,500,000 plus legal fees of \$500,000.

Some lawyers suggest that language be inserted into the fairness opinion (and engagement letter) which indicates that "responsibility" for independently verifying financial and other information has not been assumed by the valuator.

However, as noted elsewhere in this paper, efforts to limit liability through language in the opinion letter may not be sufficient to limit the degree of independent analysis required.

3.1.4 *The Mattco Forge Decision*

A Newsletter published by the American Institute of Certified Public Accountants recognized the risks and exposure to practitioners who offer litigation-support services:

" .. to provide [litigation support services], CPAs not only must be familiar with accounting principles and theory, but also must have a working knowledge of the litigation process and the rules that govern it.

“It is essential that a firm’s litigation services department be staffed with individuals with appropriate training in the litigation process. The litigation process is filled with traps for the unwary. The stakes are high and the margin of error is narrow. CPAs who do not have an understanding of the litigation process and only occasionally provide litigation services are most likely targets for a litigation services malpractice case.”²⁷

One of the most dramatic examples is a California case involving one of the Big Six accounting firms.

In June 1994, a Los Angeles Superior Court jury sided unanimously, in three separate verdicts, with the plaintiff in a malpractice suit in which negligence was alleged against Ernst & Young, awarding U.S. \$14.5 million in compensatory damages to their client, Mattco Forge, Inc., which claimed that the accounting firm caused it to lose a case (in which it was plaintiff) against General Electric, plus U.S. \$28.0 million in punitive damages.

The action — filed against Ernst & Young, the engagement partner (who was fined U.S. \$250,000) and a manager (fined U.S. \$5,000) — contained a shopping list of allegations arising from the work performed by them as *damage consultants and expert witnesses*:

- professional malpractice;
- fraud;
- negligent misrepresentation;
- breach of fiduciary duty;
- breach of contract;
- tortious breach of the implied covenant of good faith and fair dealing;
- constructive trust; and
- fraudulent concealment.

From a professional standards context — rather than a purely legal context — the following standards were considered to be violated.

(27) J.M. Moscarino, “Expert witness liability: Practical suggestions for minimizing the risk”, *CPA Expert*, Vol.

General Standard	Alleged Violation
Planning and supervision	The firm's partner did not adequately review the working papers.
Professional competence	Neither the partner nor the manager was sufficiently experienced in litigation support
Working paper annotations	The manager did not indicate a date on the recreated cost estimate sheets or otherwise disclose that the data were recreated
Communications	The manager did not inform the partner or his client (the lawyer) that the engagement files included non-contemporaneous documents.
Misleading advertising	The firm's brochures stated that its litigation support group was skilled in working with a real or apparent lack of data.
Due professional care	The engagement team appeared not to have sought assistance from more experienced litigation-support personnel who may have prepared a quality-control review and critical analysis of the work.

Until recently, U.S. courts had generally granted immunity to experts from being sued over their courtroom testimony. The courts had ruled that experts — like lawyers, judges, jurors, witnesses and other court personnel — are entitled to a “litigation privilege” protecting them from liability arising from statements made during a judicial proceeding. While originally enacted in the context of defamation actions, this privilege now applies to any communication, whether or not it amounts to a publication, and all delictual acts except malicious prosecution. Further, it applies to any publication required or permitted by law in the course of judicial proceedings to achieve the objective of the litigation, even though the publication is made outside the courtroom and no function of the court or its officers is involved. Courts have ruled that without such protection, witnesses might not testify truthfully for fear of being defendants themselves in retaliation.

The policies which underlie the “litigation privilege” are:

1. It affords litigants free access to the courts to secure and defend their rights without fear of harassment by later suits.
2. The courts rely on the privilege to prevent the proliferation of lawsuits after the first one is resolved.
3. The privilege facilitates crucial functions of the trier of fact.

In fact, it is understood that courts in the U.S. have been so reluctant to erode the privilege that they have barred claims against expert witnesses, even in instances where faulty opinions have caused serious harm. Most states also apply the privilege to statements made in pre-trial hearings and depositions. Some states even shield experts from liability for the work they do in preparation for trial, such as conducting studies or drafting opinions. In the State of Washington, for example, two plaintiffs sued a neighbour for soil subsidence, and hired an engineering firm to calculate and testify as to the cost of stabilizing the soil on plaintiffs’ land. Plaintiffs won a judgment for the amounts the expert witness testified it would cost to restore lateral support. Alleging that restoring lateral support actually proved to cost double the amount he estimated at trial, however, plaintiffs later sued their own expert witness for negligence. The Washington Supreme Court, also relying on the common law immunity of parties and witnesses from subsequent damages liability (and not on a statute), held the expert witness’ testimony to be immune from suit.

While several U.S. cases have applied the litigation privilege to protect statements by an expert witness, they involved suits against expert witnesses who function *adversely to the plaintiff*. For example, in the California case, *Carden v. Getzoff* (1987), such privilege protected an accountant hired by the wife to value her husband’s medical practice in divorce proceedings despite there being falsehoods in the accountant’s report.

The Court in *Mattco Forge, Inc. v. Ernst & Young* also distinguished among an expert witness (1) hired jointly by adverse parties as a neutral, dispute-resolving participant, (2) hired by an opposing party and (3) hired by his own client. Ernst & Young was not a “neutral expert”, but one hired by the plaintiffs. If an expert witness’ negligence and breach of contract caused the client to lose the case, that does not expand freedom of access to the courts. Applying the litigation privilege in this circumstance does not encourage witnesses to testify truthfully; the court held that by shielding a negligent expert witness from liability, it has the opposite effect. Applying the privilege where the underlying suit never reached the trial stage would also mean that the party hiring the expert witness would have to bear the penalty for the expert witness’ negligence. That result would scarcely encourage the future presentation of truthful testimony by that witness to the court.

Mattco Forge had retained Ernst & Young to calculate damages for lost profits and provide expert-witness testimony in an action against General Electric Co. Mattco alleged that it had lost a valued contract because of racial discrimination on the part of GE (Mattco’s president, Mateo Minguez, is Hispanic).

In preparing the case, Ernst & Young’s litigation consultant (Mr. Thomas W. Blumer, an auditor apparently with no experience in litigation support) asked Mattco, his client, to fill gaps in the company’s records by creating estimate sheets with respect to Mattco’s customer, General Electric. To calculate the client’s estimated lost profits, Ernst & Young needed complete information about Mattco’s prior contracts with GE; but neither the client nor Mr. Blumer could locate all the original GE job-cost estimating sheets. Blumer asked Mattco for figures from the missing GE estimate sheets. The client recreated estimate sheets and gave them to Blumer. Mattco informed Ernst & Young that the documents were actually recreated job-cost estimate sheets for GE contracts that contained true recreated cost information.

The litigation-support function, however, often involves putting together non-contemporaneous financial records based on estimates in order to calculate damages, but such recreated records must always be disclosed as such; they may not be passed on as original, contemporaneous records.

Mr. Blumer, however, handed over the estimates to the other side, along with Mattco's other business records, as if they were contemporaneous. GE, seizing on the mistake, accused Ernst & Young's client of fabricating court documents and was able to have the suit dismissed. Mattco, in turn, sued Ernst & Young for malpractice, fraud and negligent misrepresentation.

Mattco's attorney told *The Wall Street Journal* that:

The initial mistakes we allege were the result of lack of proper training and supervision The theory we pursued at trial was that [Blumer] was ignorant of the consequences of his actions, and, since he didn't have training, he didn't appreciate that litigation support [is] a totally different animal than auditing.

The Los Angeles Superior Court jury found Ernst & Young guilty of fraud on two counts: (1) for advertising its expertise in litigation support when Mr. Blumer had no training and (2) for later insisting that the firm did not rely on the estimates in calculating its client's lost profits

Interestingly, the Federal District Court in the earlier case had even decided that Mattco had attempted in their suit against GE to "fraudulently increase the damages they seek to claim in this action, altered and fabricated estimate sheets used to help calculate those damages". The court further found that E&Y's client "knowingly produced those false estimate sheets to [E&Y], and thereby perpetrated a fraud upon [E&Y], this Court and the judicial process". (However, the Federal District Court did not adjudicate a dispute between Mattco and Ernst & Young.)

In an interview with *The Wall Street Journal*, the special liability counsel to the New York State Society of Certified Public Accountants commented that:

There is no logical reason why any expert should not be held liable for malpractice A person may not know what they're doing, may make mathematical errors, give erroneous advice on whether there is a claim or what strategies they should pursue ... logically there's no reason why a client shouldn't have recourse.

Columbia University law professor John Coffee made the following point as well: “If you want to discourage fraud in the courtroom, the worse thing to do is to tell the expert that no matter what he says there is no liability”.

While the case may be under appeal, it should serve as a warning to accounting professionals who wish to render litigation-support services. As with any other professional services, the professional standards designed to protect the public as well as the CA apply to litigation-support engagements (even if not specifically drafted *vis-à-vis* litigation-support *per se*).

3.2 Selected Canadian Professional Liability Cases

American courts are not unique in attempting to curb the potentially unlimited liability facing professional information suppliers. Recent Canadian court decisions suggest that the general trend is moving toward the creation of professional liability standards which at least require that a professional receive notice of the scope of liability associated with an undertaking before potential liability attaches. This enables the professional to assess the risks and make rational decisions regarding the undertaking.

For example, in *Rangen Inc. v. Deloitte & Touche*²⁸, the plaintiff alleged that it extended credit to a customer based upon financial statements prepared by Deloitte & Touche. The British Columbia Supreme Court denied plaintiff’s negligent misrepresentation claim against the auditor, holding that “[t]here is neither allegation nor suggestion in the pleadings that the financial reports which the plaintiff alleges it relied on were prepared specifically for the special class of trading creditors in which the plaintiff claims membership.”²⁹ The court concluded that the situation would have been different if Deloitte had been advised that the financial statements were to be used to obtain financing or if plaintiff had communicated to the auditor its intentions to rely on them. In other words, if the defendant had “intended to benefit” the plaintiff or communicated with plaintiff to an extent sufficient to establish a relationship “akin to privity” (*Ultramares*), negligence liability might attach. To hold otherwise,

(28) 79 BCLR (2d) 31 (1993).

(29) At page 38.

however, “would saddle the defendant with ‘liability in an indeterminate amount for an indeterminate time to an indeterminate class.’”³⁰

3.2.1 *The Roman Corporation Ltd. Decision*

Recent Canadian court cases suggest that the general trend is moving toward the creation of professional liability standards which at least require that a professional receive notice of the scope of liability associated with an undertaking before potential liability attaches. This enables the professional to assess his or her risks and make rational decisions regarding the undertaking.

For example, in *Roman Corporation Ltd. v. Peat Marwick Thorne*³¹, an Ontario court fashioned a stringent rule analogous to *Bily*’s privity requirement, holding that any suit based upon a negligent auditor’s report must be brought by the corporation itself or by one of its shareholders through a derivative action. Plaintiffs, who were shareholders in a group of companies audited by Peat Marwick, sued the auditors, alleging that the former detrimentally relied on clean audit reports in investing in the group of companies. In denying plaintiffs’ negligence claim, the court held that “it would appear that any suit in respect of a negligent failure of an auditor to report properly on [the corporation’s financial condition] must be brought by the corporation itself or by a shareholder through a derivative action.”³² (That negligence suits may only be brought by the corporation which engaged the auditor suggests an endorsement of *Bily*’s “privity of contract” requirement for professional negligence claims.)

In explaining the basis for its holding, the Ontario Court appears to have explicitly endorsed some of the policies underlying the *Bily* decision:

There is no doubt that the plaintiffs, if they were controlling shareholders, could have contracted separately with the auditors or that they could have made it known to the

(30) At pages 38, 39 (citing *Ultramares, supra*, 174 N.E. at 444).

(31) 11 O.R. (3d) 248 (1992).

(32) *Id.*

auditors that they wished to have a separate report which would allow them to engage in even closer supervision of the management of the corporations for the benefit of their control shareholdings I query if in these situations there would not have had to have been separate remuneration paid to the auditors.³³

3.2.2 *The Burgoyne Decision*

In *Royal Bank of Canada v. Burgoyne*,³⁴ the Royal Bank loaned Hiltz \$200,000, which was secured by a second mortgage on his inn. Hiltz defaulted on the loan and the bank alleged that an appraisal of the inn, prepared by Burgoyne for Hiltz, had significantly overvalued the property at \$860,000. The Royal Bank sued Burgoyne, an accredited appraiser for damages for negligent misrepresentation of value.

The Nova Scotia Supreme Court allowed the action. The trial court held that the Royal Bank was one-third contributorily negligent because its offer failed to recall a previous report placing a value of \$554,000 on the property. The court also held that a disclaimer clause did not absolve the appraiser from liability to the Bank. The appraiser appealed.

The Nova Scotia Court of Appeal allowed the appeal, holding that although the disclaimer clause would not protect the appraiser from liability to his client, Hiltz, it was sufficient to protect him from liability to the Bank.

The Bank had relied on the appraisal and suffered a loss when Hiltz defaulted on the loan. As noted above, the Bank sued the appraiser for negligent misrepresentation. In holding that the disclaimer was effective to excluded liability to the bank, the Court stated that it was unreasonable for the Bank to rely on the appraisal and, accordingly, the appraiser owed no duty of care to the Bank. The Bank should have requested the appraiser's permission to use the report or at least required Hiltz to provide an unqualified appraisal. In choosing to do neither, the Bank assumed the risk that the appraisal was unworthy of reliance.

(33) At pages 259, 260.

(34) 147 NSR (2d) 5; 426 APR 5.

The trial judge found the appraisal report to be both inaccurate and misleading, finding that the appraiser was negligent. The judge held, however, that the Bank was partly responsible for the loss occasioned by the said negligence, by forgetting the earlier statement of net worth. That statement noted that there was a 1989 appraisal of the property, prepared by the same appraiser, with a market value of \$554,000. This would have caused the Bank to question the value arrived at in the more recent appraisal.

In his decision, the trial judge made the following findings of fact:

1. The appraiser's report was inadequate and the appraised value of the inn was inflated.
2. Nowhere in the appraiser's report did he limit the purpose for which the report may be used and, in addition, the letter of transmittal to his client, which was not delivered to the Bank, did not suggest a limitation on the use to which the report may be made by the client, Mr. Hiltz.
3. The disclaimer contained in the report appeared to be unethical, considering the Regulations prescribed the Appraisal Institute of Canada, of which the appraiser was a member, in that it purported to exempt or exclude responsibility for the entire report.
4. The branch manager of the Royal Bank, had he remembered the reference in his file to the earlier report, would have made enquiries and raised with the appraiser questions on the extent of the increase in stated value between the earlier report and the subject report which was issued some thirteen months later.
5. The branch manager, in approving the loan, relied on the subject appraisal report.

The trial judge had found the Bank to be contributorily negligent:

"In assessing the degree of responsibility, as between the defendant's negligent preparation of the appraisal report and [the branch manager's] negligence in failing, because of material available in his file, to question the stated market value, I have considered the primary negligence to be that of Mr. Burgoyne in preparing the report.

Professional persons retained to provide 'expert opinions' are expected to exercise a 'reasonable degree of care, knowledge and skill' in fulfilling their responsibility. Clearly, Mr. Burgoyne did not do so. Although the failing by [the branch manager] would likely have caused him to question the conclusion of Mr. Burgoyne, such an admission does not eliminate the negligence in preparation of the report as a cause, and in this case, the most significant cause, of the plaintiff's loss. I would therefore apportion responsibility for the loss occasioned to the plaintiff as two-thirds to Mr. Burgoyne and one-third to [the branch manager of the Royal Bank]."

The Court of Appeal noted that in assessing the reasonableness of reliance it was necessary, however, to also consider the disclaimer clause. If, in the face of a disclaimer clause, it would be unreasonable to rely on the information, then a duty of care would not arise (referring to *Hedley Byrne & Co. v. Heller and Partners*³⁵ or, alternatively, using *The Queen v. Cognos*³⁶ statement of the test, the fourth requirement is not satisfied).

In *Queen (DJ) v. Cognos Inc.*, the Supreme Court of Canada restated the test for recovery for negligent misrepresentation. Mr. Justice Iacobucci stated (at page 134):

"The required elements for a successful *Hedley Byrne, supra*, claim have been stated in many authorities, sometimes in varying forms. The decisions of this Court cited above suggest five general requirements: (1) there must be a duty of care based on a 'special relationship' between the representor and the representee; (2) the representation in question must be untrue, inaccurate or misleading; (3) the representor must have acted negligently in making said representation; (4) the representee must have relied, in a reasonable manner, on said negligent misrepresentation; and (5) the reliance must have been detrimental to the representee in the sense that damages have resulted."

Mr. Burgoyne had included the following disclaimer clause in his report:

"Contingent and Limiting Conditions"

...

(35) [1964] AC 465 (HL).

(36) (1993), 147 NR 169; 60 OCA 1; 14 CCLT (2d) 113 (SCC).

“The client to whom this report is addressed may use it in deliberations affecting the subject property [which would include matters of financing] only, and in so doing, this report should not be extracted, but used in its entirety.”

...

“In preparing the foregoing Appraisal Report, the undersigned appraiser has employed the usual methods and procedures used by Appraisers in Nova Scotia, and the result is the product of his careful and considered opinion; however, this Appraisal Report is the opinion of the appraiser only — and under no circumstances whatsoever shall the Appraiser personally be held liable for any loss or damage that may occur to any person or persons by reason of their reliance upon this Appraisal Report.”

The trial judge had held that the above disclaimer clause was not adequate to relieve the appraiser from liability for negligent misstatement and also concluded that the Limiting Conditions were ambiguous, resolving that ambiguity against the appraiser.

During his discovery, the appraiser testified that he did not know that the appraisal report was to be used for financing purposes. His client had told him that he required the report to review the feasibility of expanding the motel with architects and engineers. He further testified that he would not have authorized the Bank to use the report, if asked.

The appellate court noted that the branch manager was aware of the disclaimer clause. He had, in the past, relied upon reports prepared by the same appraiser and containing the same provision. In fact, on one occasion, being concerned about the disclaimer, he had contacted the appraiser and sought and received permission to use a report, notwithstanding the disclaimer clause. He did not do so in this case: “The appraiser is not seeking to shield himself from a claim by the client who commissioned the report, but from a claim by a third party.”

The Court of Appeal noted that it was open to the Bank to contact the appraiser for permission to use the report, or, alternatively, to require that the clients provide an unqualified report:

“In choosing to do neither, the Bank assumed the risk that their report was not worthy of reliance. It cannot now turn to the appraiser for recovery. Applying the *Cognos* test, the Bank’s reliance on the report was unreasonable. Using the *Hedley Byrne* analysis, the

duty of care does not arise, the appraiser not having assumed the risk. The Bank's claim against the appraiser must fail."

3.2.3 *The Wolverine Tube Decision*

In *Wolverine Tube (Canada) Inc. v. Noranda Metal Industries Ltd. et al*³⁷ the defendant, Noranda, retained a company, Arthur D. Little of Canada, Limited ("Little"), to prepare environmental assessment reports on three properties owned by Noranda, in contemplation of sale of the properties. It was a term of the agreement between Noranda and Little that the reports were not to be used outside Noranda's organization without prior permission. Little had no knowledge of a sale to Wolverine. The reports negligently failed to mention areas of contamination and violations of environmental laws. Without the permission of Little, Noranda provided the reports to Wolverine, prior to its purchase of the three properties. Wolverine initiated an action for damages against Noranda and, in negligence, against Little. The latter suit was dismissed as disclosing no cause of action. The Court held that Little's disclaimer clause in the environmental assessment agreements was sufficient to avoid liability:

"This report was prepared by [Little] for the account of Noranda Inc. The material in it reflects [Little's] best judgment in light of the information available to it at the time of preparation. Any use which a third party makes of this report, or any reliance on or decisions to be made based on it, are the responsibility of such third parties. [Little] accepts no responsibility for damages, if any, suffered by any third party as a result of decisions made or actions based on this report."

The trial decision was upheld on appeal. Writing for the Court, Finlayson, JA stated (at page 581) that "[t]he language of the disclaimer clause in the reports is broad enough to prevent the assumption of a duty of care to Wolverine ...".

(37) (1995), 87 OAC 191; 26 OR (3d) 577 (CA).

4. AUDITORS IN QUEBEC

Unlike auditors practising in the common law provinces, Quebec auditors are liable to any third parties which might rely on the relevant financial statements. Unlike the “duty of care” factor in a negligence action in the common law provinces, Article 1457 of the Quebec *Civil Code*³⁸ states the general principle governing negligence cases:

“Every person has a duty to abide by the rules of conduct which lie upon him, according to the circumstances, usage or law, so as not to cause injury to another.”

Because there is no definition or restriction as to the interpretation of the term, “another” in Article 1457, the “duty of care” is different in the Province of Quebec.

In *Caisse Populaire de Charlesbourg v. Michaud*,³⁹ the defendant had provided an audit opinion with various qualifications. The financial statements were used to obtain a bank loan. The bank sued the auditor but lost the case (similar to the matter in *Royal Bank v. Burgoyne, supra*). However, the Quebec Court of Appeal stated:

“When an accounting firm accepts a professional mandate, in principle it must accept the consequences which result from the representations it makes, independent of the original purpose of the document. Professionalism is founded upon public confidence in the quality of the acts performed.” [Translation.]⁴⁰

(38) S.Q. 1991, c. 64.

(39) (1990) 30 QAC 23.

(40) At page 29.

In *Irwin Management Consultants Ltd. v. Thorne Riddell*⁴¹, the Quebec Court of Appeal affirmed the decision of the Superior Court, finding auditors liable:

“Defendants suggest that any damages resulting from its negligence would have been suffered by [their audit client] and not by Plaintiffs, since the contract was between the Company and the defendant.

“The financial statements bearing the signature of the auditor lead the reader to believe that an audit was done in accordance with generally accepted standards including substantive testing when required. Defendant assumed the consequence of its representations notwithstanding the contract between the parties.

“The Court concludes that there is a direct ‘lien de causalité’ between the fault of the Defendant and the damages caused to Plaintiff Irwin. The latter was lulled into a false sense of security by the erroneous financial statements.”⁴²

In a 105-page decision of the Quebec Superior Court in 1996, which involved a professional liability claim by a client against a firm of Chartered Accountants for failing, as auditors, to detect fraud committed by the company’s bookkeeper, the judge devoted more than 40 pages of his decision in the analysis of the expert evidence presented at trial.

In this case, the management of a major restaurant and bar operation had been committing its own fraud, by making undeclared cash sales and pocketing a portion of staff gratuities. They had been caught a few years earlier by the Revenue Department, charged with tax evasion, and were subject to fines and penalties.

Significantly, in giving his reasons as to why he disregarded the report of the plaintiff’s principal auditing experts, the judge provided guidance to aspiring witnesses who may wish to provide expert evidence in the future.

Without delving into the specific details of the litigation itself, the fraud the defendant auditors were alleged to have negligently failed to detect was described as follows:

(41) (1995), RRA 589.

(42) At page 595.

“In essence, the office manager misappropriated cash receipts of the company by intercepting entire days’ deposits or partial deposits from the bank deposit pouch. The corresponding documentation related to the deposit was then either removed from the records of the company or she intelligently and carefully altered the documents and the books of the company to conceal her actions.”

The plaintiff retained, as its experts, two Chartered Accountants C one (Expert Witness A) from the auditing firm which had replaced the defendant firm and the other (Expert Witness B) from an outside accounting firm. The defendant auditors retained the services of an expert (Expert Witness C) from a “Big Six” accounting firm.

Expert Witness A

Expert Witness A was a member of the new (replacement) auditing firm of the plaintiff. However, he testified that he was not the author of the report filed in Court. He said that he was asked to testify at the trial as an expert, at the last minute, but that the report was actually prepared by another partner of his firm.

The judge held that such practise was improper. While an accounting firm may be retained to provide professional services collectively; but when it comes to *expert evidence*, the individual who prepared the report and opined on it based on his or her own work is the one who should testify in Court. Moreover, the judge noted that Expert Witness A was a member of the new auditing firm which replaced the defendant auditing firm and said that such a situation appeared deplorable in that this expert was a member of the plaintiff’s auditing firm, i.e., Expert Witness A was an expert witness for the plaintiff and, at the same time, was with the plaintiff’s auditors. Because of this, the Court’s evaluation of the testimony of Expert Witness A would have to be carefully weighed.

Expert Witness A’s report was essentially dismissed because the expert admitted that neither he nor members of his firm had examined the working papers of the defendant auditing firm and could therefore not comment as to the work performed. The judge questioned this expert’s credibility in arriving at such

a conclusion without reviewing the defendant's working papers. The judge then had the following harsh words to say about Expert Witness A (my translation from the French):

"Here without doubt is what happens when a bad expert is presented as a witness to the Court and wears two hats at the same time. His credibility takes a hit and the probative value of his evidence and his report which should be supported is seriously put in doubt and becomes questionable."

The judge also said (translation):

"And still neither this expert nor the members of his firm who had participated in the preparation of the reports emanating from the firm were able to uncover the management fraud notwithstanding that they had the mandate to do an investigation and find the fraud [committed by the bookkeeper] and the irregularities. Yet [Expert Witness A] and his firm criticized the defendant auditors for not uncovering the fraud when the latter's mandate was nothing more than to prepare the audited financial statements."

Expert Witness A was criticized by the judge when confronted with the fact that the owners of this restaurant business were, themselves, involved in tax fraud. Expert Witness A insisted that this did not have any effect on his opinion, as he only considered the bookkeeper's fraud (which was the subject of the litigation). The Court found this not to be credible, viewing Expert Witness A to be more of an advocate than an objective expert witness providing evidence on professional standards. The judge underscored the irony that the plaintiff's expert had failed, after performing his own forensic audit, to detect the tax fraud perpetrated by the owners. How could Expert Witness A complain that the defendant auditors were negligent in failing to detect the fraud committed by the bookkeeper when there was no reason to suspect this at the time?

Expert Witness B

Expert Witness B also gave evidence on behalf of the plaintiff company. His mandate was to determine whether the defendants were negligent in the performance of their professional responsibility as auditors of the plaintiff.

The judge's first criticism was that Expert Witness B's report essentially constituted a *verbatim* commentary from the CICA *Handbook* relating to professional standards and management responsibility.

Secondly, the witness admitted during his examination that his review really covered only an eighteen-month period and not three years as he had indicated in his report.

Expert Witness B was also questioned on the implication of the management fraud in the matter. He responded that it did not concern him because his mandate was not to evaluate such a situation and, in any event, it had no relevance for purposes of his investigation and opinion. The judge found this to be very surprising, as the Court, to the contrary, found the management fraud to be a significant factor:

"It is important at this point to place the matter in a proper context, i.e., at the point in time and taking into account the scope of the professional services requested of [Expert Witness B].

"His services were retained near the end of 1993. There was already, apparently, the enquiries of the former auditors and the new auditors and the filing of their respective reports with the plaintiff company. One major mandate had already been completed. [Expert Witness B's] only mandate was to verify the facts already gathered and to confirm or not confirm the conclusions arrived at by the new auditors with respect to the defendant auditors' responsibilities.

"His mandate was therefore limited. It was taken for granted that [the bookkeeper] was the only person responsible for the fraud and therefore he did not look into the implications of the management fraud. It is in this context and with such perspective that it is necessary to evaluate the work of [Expert Witness B].

"Faced with such a situation ... one must be careful not to accept and quickly approve the conclusions of an expert, whoever the expert may be. One should question whether the expert witness considered the situation by using hindsight or by second guessing, and whether the expert evaluated the matter in a proper fashion and in a satisfactory way. It is necessary to avoid falling into the trap of using hindsight and considering

issues after the fact; the auditors [in this case] were unable to benefit from the use of retrospective evidence.”

“Accomplishing an auditing task constitutes an exercise where the standards and rules apply to a precise context. Preparing an expert’s report is different from the context of a mandate where the standards and rules are very specific. To accomplish this task and be credible, it is necessary to be free of subjectivity and, instead, to be impartial and independent and to consider the situation without second guessing or using hindsight. It is always easier to understand a situation after the fact and to analyze it from all of the various angles which were unavailable when the actual events occurred.”
(Translation.)

After hearing the testimony of Expert Witness B, the judge noted that the witness’ services had been retained toward the end of 1993. He had access to the enquiries made by the defendants (when they were acting as auditors) and by the new auditors, as well as to the reports they prepared for their client, the plaintiff. One important element of work had already been started and completed. Expert Witness B had only to verify the data already gathered and to either confirm or reject the conclusions of the new auditing firm as to the defendant auditor’s professional responsibility.

“[Expert Witness B’s] mandate was therefore limited. He took for granted that [the bookkeeper] was solely responsible for the defalcations and did not involve himself with the implications arising from the management fraud. It is in this context and with this perspective that it is necessary to evaluate the services of [Expert Witness B].”

The judge then observed that generally-accepted auditing standards are applied in the conduct of an audit, but the preparation of an expert’s report is different from a professional mandate where the standards and rules are very specific.

After hearing other evidence including that of Expert Witness C on behalf of the defendant auditors, the Court found the defendants not to have been negligent in the performance of their duties as auditors, having failed to detect the \$1.1 million fraud.

Curiously Expert Witness B, who appeared to testify against the defendant auditors with particular enthusiasm, had the following reply in his direct examination by the lawyer who had retained him:

“Well, in fact, ... you yourself have asked me on several occasions and I have reviewed a few other files uh, these kinds of cases are something which I am very reluctant to get involved in simply because we are dealing with professional confreres and this is kind of a unpleasant task, so in most of the cases where you have asked me to look in I have recommended that in fact the client should not proceed. I agreed to look at this file under the condition that if I was not satisfied that there was serious negligence and which would have proved harmful to the client, that I would not accept the file, that I would back away from the file.”

The judge hearing Expert Witness B make such a statement, requested clarification saying, “I’m sorry, I didn’t get that.” Expert Witness B answered:

“ ... when [counsel for the plaintiff] asked me to take this file, I said that I really didn’t appreciate doing cases, obviously it’s like a doctor testifying against a doctor and so I said that I would agree to proceed only if after I did some investigation, I was convinced that there was some in fact negligence.”

The judgment is significant in that the Court also dealt with what an ordinary audit (as opposed to a forensic audit) should or should not reveal. Moreover, there was significant commentary by the judge with respect to management fraud (which was unrelated to that perpetrated by the company’s bookkeeper) in the context of a financial (as opposed to forensic) audit.

The case even touched upon the requirements of the Institute of Chartered Accountants’ Code of Ethics concerning criticism by one member of another member’s work, without communicating with the other member.

One clear lesson to be learned from this judgment is that objectivity and impartiality, actual as well as perceived, are paramount when providing expert evidence before a trier of fact. Advocacy by the expert is unacceptable.

5. SUGGESTED WORDING FOR ENGAGEMENT LETTERS

The information-supplying professional will find his or her product reaching more people, through more varied media, more quickly than ever before. As a result, the uses of opinion-providers' products are becoming increasingly unpredictable and the scope of potential liability is becoming even greater. Nevertheless, professionals can affirmatively act to limit their potential risks when supplying information or opinions. Protective measures such as the use of disclaimers, drafted by the opinion-giver's legal counsel, might be employed by professionals, depending, in some cases, on the particular legal jurisdiction. A few cases provide an example.

Subject to the accountant, valuator, financial analyst or other professional's seeking legal advice from his or her counsel, the following is some food for thought:

1. Both the professional engagement letter and the opinion itself (if feasible) should specifically identify the client. References to third parties should be limited or, unless material to either the assumptions or conclusions contained in the opinion, excluded altogether. In that regard, the following language might be considered with counsel in drafting the disclaimer:

[The client(s)] alone contracted for and [is/are] the intended [beneficiary/beneficiaries] of this Opinion. This Opinion may not be relied upon by any other person or entity without our express, prior written consent.⁴³

2. In the engagement letter and opinion, the *recipient* should acknowledge that it is conducting its own due diligence and analysis (if commercially practical). The engagement letter and opinion should also set forth the purpose for which the recipient will use the opinion. For example, a fairness opinion might contain the following language:

(43) Such limiting language will not, in and of itself, immunize professionals against fraud claims. In most instances, a potential fraud plaintiff will not be a party to the engagement contract so as to be bound by its terms and conditions. (Most jurisdictions in the U.S. proscribe contractual limitations on liability for intentional misconduct, such as fraud. Such limiting language can, however, be powerful evidence of a lack of justifiable reliance.)

In connection with the proposed sale of shares which the Company is considering, the Company has conducted its own independent investigation, due diligence and financial analysis. The Company has requested [the professional's] opinion to provide a secondary, independent verification of, rather than a substitute for, the Company's analysis.

3. The opinion itself should specifically delineate all facts, representations, assumptions and other information upon which it is based and caution that material changes in these assumptions could impact the conclusions of the opinion. The professional should indicate whether the facts and representations underlying the opinion have been independently verified. This will put potential third-party lenders or investors on notice that they are required to perform their own due diligence. Furthermore, such language notifies potential recipients that they assume the risk that any fact or assumption underlying the opinion is incorrect.

Other types of wording might include, as appropriate:

This Opinion is not intended for general circulation or publication, is it to be reproduced or used for any purpose other than that outlined above, without our written permission in each specific instance. We do not assume any responsibility or liability for losses occasioned to the Company, the directors and shareholders thereof, or to other parties as a result of the circulation, publication, reproduction or use of this Opinion contrary to the provisions of this paragraph.

We reserve the right (but will be under no obligation) to review all calculations included or referred to in this Opinion and, if we consider it necessary, to revise this Opinion in light of any facts, trends or changing conditions existing at the valuation [or damage] date which become known to us subsequent to the date hereof. We do not assume any responsibility hereafter to update or revise this Opinion if and to the extent such conditions may change subsequent to the date hereof. Our analysis is based on market, economic, financial and other conditions as they existed and can be evaluated as of the valuation [or damage] date.

Nothing contained herein is to be construed as a legal interpretation, an opinion of any contract or document or a recommendation to invest or divest.

In preparing this Opinion, we considered, among other things, the financial forecasts prepared by management. The said forecasts, which were reviewed by us for purposes of our analysis, were based on management's assumptions concerning future events and circumstances. The assumptions upon which the forecasts were based are those which management believe are significant to the forecasts or are key factors upon which the financial results of the enterprise depend. Some assumptions may not materialize and unanticipated events and circumstances (both favourable and unfavourable) may

occur during the period of forecasted results. Therefore, the actual results achieved during the forecast period may vary from the forecast as initially established, and such variations may be material. We have interviewed management and reviewed the bases and assumptions upon which the forecasts were developed.

Of course, the disclaimer of the professional firm referred to above in the *Credit Lyonnais* decision should always be considered:

This Opinion is furnished solely for [the addressee's] benefit and may not be relied upon by any other party without our express prior written consent. This Opinion is delivered to each recipient subject to the conditions, scope of engagement, restrictions, limitations and understandings set forth in this Opinion.

Also, the disclaimer used by Arthur D. Little in the *Wolverine Tube* case referred to above contains language which appears effective, but should nonetheless be reviewed with Quebec counsel, if appropriate:

This report was prepared by us for the account of [the client commissioning the report]. The material in it reflects our best judgment in light of the information available to us at the time of preparation. Any use which a third party makes of this report, or any reliance on or decision to be made on it, is the responsibility of such third party. We accept no responsibility for damages, if any, suffered by any third party as a result of decisions made or actions based on this report.

Finally, if the professional must communicate with potential third-party lenders or investors, these communications should be carefully documented and limited to obtaining information germane to particular assumptions or conclusions contained in the opinion. Such precautions are necessary so that the professional does not unintentionally create a relationship “akin to privity” which establishes a negligence duty to such third party. For example, correspondence with a third-party investor or lender (and perhaps the opinion itself) could state that the professional has relied upon information or representations provided by that third party in reaching the conclusions of the opinion. In fact, the opinion should also describe the purposes of these third-party communications.

6. CONCLUSION

No professional would wish to be tainted as those referred to in *Heppner v. Schmand*⁴⁴.

In *Heppner v. Schmand*, in his decision regarding special costs, Justice Shaw of the Supreme Court of British Columbia stated that “when Mr. Harper [the expert engineer] testified, he conducted himself as an advocate, not as an independent expert”.

His Lordship then stated:

“The Plaintiff asks that I express the Court’s disapproval of the Defendant’s use of the clearly flawed reports and testimony of Mr. Harper of Baker Materials Engineering Ltd. by ordering special costs or increased costs.

“ ... in addition, counsel for the Plaintiff brought to my attention several cases in which similar evidence given by members of [Baker] has been rejected for reasons largely like my own. Those cases include: *Schlieske v. Thomson* (30 January 1991), Vancouver Registry Number B871397 (BCSC); *Hojjati v. Verjee* (29 December 1993), Vancouver Registry Number B921667 (BCSC); *Cripps v. MacRae* (31 May 1994), Vancouver Registry Number 93-06175 (BC Prov. Ct.); *Pfeiffer v. Vanderweyst* (19 January 1995), Vancouver Registry Number B930423 (BCSC); *Gabriel v. Thompson* (22 November 1995), Vancouver Registry Number C94-09360 (BC Prov. Ct.). I asked counsel for the Defendant whether he was able to refer me to any contrary decisions and he advised that he had not run across any.

“In [*Gabriel v. Thompson*], Judge C.L. Bagnall reviewed several previous decisions and made the following observations with respect to the evidence of an engineer with Baker (at p. 11):

‘After so many instances of negative judicial comment, over so many years, for ICBC [Insurance Corporation of British Columbia] to continue to tender Mr. Gough’s incomplete and too far-reaching opinions is, in my view, utterly inappropriate.’

“Judge Bagnall further said (at p. 12):

‘I found his lack of professionalism disturbing. The fact that he conducted himself similarly in the past, has received judicial admonishments as a result and yet continues to perform his role as an expert witness in the same fashion I find shocking.’

(44) Supreme Court of British Columbia, Campbell River Registry, No. S1530, May 21, 1996.

“In my opinion, it does not make any difference that the present case involves a different engineer. In each case the engineers were employed with Baker and both of them gave substantially similar evidence.

“ ... it was open to ICBC to instruct counsel not to use the Baker reports and Mr. Harper’s evidence. ICBC did not do so.”

Increasingly, professional opinion-providers are becoming targets in lawsuits filed by investors and lenders. When the professional service is tendered in the context of a large financial transaction such as a merger, the scope of potential plaintiffs and liability can be virtually limitless.

So concerned is The Canadian Institute of Chartered Accountants that it has been making representations at Senate Committee hearings, identifying the existing régime of joint and several liability as the greatest existing threat to the auditing profession. Such régime could place the entire burden of a large settlement on auditors, even though courts may find them to be only partially responsible for economic losses. Witnesses for the CICA identified to the Senate Committee, for example, the cases involving Castor Holdings, Standard Trust, Confederation Life and Royal Trust; these actions have an aggregate claim of approximately \$3 billion.

Nevertheless, professionals can avail themselves of legal protections recognized by many American and Canadian courts through the careful drafting of language in engagement letters and opinions, but above all, through performing the highest-quality professional services — services that would withstand the most rigorous scrutiny in a peer review. Practitioners are warned that, if appropriate, their own professional standards and rules of professional conduct can and will be used by the plaintiff to help establish liability resulting from professional negligence, let alone to demonstrate that the practitioner also breached the Code of Ethics in not adhering to the standards of his or her professional society.