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Proportionate Liability under the CBCA in the Context of Recent Corporate Governance Reform: Canadian Auditors in the Wrong Place at the Wrong Time?

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PROPORTIONATE LIABILITY UNDER THE CBCA IN THE CONTEXT OF RECENT CORPORATE GOVERNANCE REFORM: CANADIAN AUDITORS IN THE WRONG PLACE AT THE WRONG TIME?

Poonam Puri* and Stephanie Ben-Ishai**

In the recent Canada Business Corporations Act\(^1\) amendments implementing a proportionate liability scheme, auditors appear to be winners. This is consistent with the trend in the past several years as a result of which Canadian auditors have been successful in narrowing the scope of their liability both through legislation and through common law. Going forward, however, it is fair to say that auditors will be losers unless the accounting profession re-evaluates its role and responsibilities to its stakeholders. Given the accounting and corporate governance scandals North America has witnessed in the past few years, as well as the actual and anticipated regulatory response in Canada, the scope of auditor liability is bound to expand once again. In addition to the recent creation of the Canadian Public Accountability Board,\(^2\) auditors can expect to lose some aspects of

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1. R.S.C. 1985, c. C-44. Bill S-11, cl. 115, adding Part XIX.1 (ss. 237.1 to 237.9) to the CBCA.

2. On July 17, 2002, federal and provincial regulators and the accounting profession announced the creation of the Canadian Public Accountability Board (CPAB) to administer and enforce a new system to oversee the auditors of public companies in Canada. The CPAB requirements will provide that Canadian chartered accountant (CA) firms in the course of auditing public companies must accelerate the adoption of more stringent standards on auditor independence, including limits on the types of consulting services that can be provided to auditor clients; rotate the lead partner on an audit on a regular basis; and require a second partner to review every audit. The CPAB will conduct inspections of auditors of public companies and will have the authority to levy sanctions against auditors who fail to remedy significant deficiencies identified by the CPAB, and regulators may take additional action as warranted. See Ontario Securities Commission, News Release 02/17, “New Independent Public Oversight for Auditors of Public Companies Announced by Federal and Provincial Regulators and Canada’s Chartered Accountants” (July 17, 2002).
their self-regulatory status and be subject to greater direct regulatory oversight.³

This article makes the case that the Canadian regulatory framework is changing in two ways. First, following a reduction in auditor liability, including the amendments creating a proportionate liability scheme, we are once again seeing an expansion of that liability. Second, coming from an era that mistrusted litigation as a potential corporate governance mechanism, we are now recognizing the benefits of litigation as a tool to ensure the accountability of auditors, other professionals and corporate actors.

We argue that these are positive developments towards finding a made-in-Canada response to the recent Enron-type corporate governance scandals that have arisen in the United States. The loss of high standards of transparency, independence and accountability for auditors is part of the Enron saga that we may be able to avoid in Canada. Indeed, it may be the case that we have not seen an Enron-type scenario in this country because of our more principled corporate culture, as compared with the American “loophole mentality”. Nevertheless, it is equally true that, because we were slower to narrow auditor liability than was the United States, the results that could have occurred and did ensue there did not have time to emerge in Canada.

This article first situates auditor liability in the context of the role of the auditor in corporate governance, and in the context of the role of liability as a corporate governance mechanism. Secondly, we focus on the legislative and judicial means through which auditors have narrowed their liability in Canada. That portion of the article will focus in particular on the CBCA amendments changing the longstanding scheme of joint and several liability to one of proportionate liability, which extends not only to auditors but to other defendants for actions in relation to the CBCA. This article

³. The Canadian Institute of Chartered Accountants’ Public Interest and Integrity Committee recently published for comment proposed revised standards of independence governing auditors that would either prohibit or place strict limits on auditors performing a range of non-audit services for listed entities for which they are auditor; prohibit the lead partners on an audit engagement team from providing audit services to the issuer for more than five consecutive years; and prevent an accounting firm from auditing an issuer’s financial statements if certain members of management of that issuer had been members of the accounting firm’s audit engagement team within the one-year period preceding the commencement of audit procedures. See proposed Independence Standards of the CICA, s. 204, at <www.cica.ca> (last accessed March 24, 2002).
will conclude by considering the recent American corporate governance scandals. We recount the dominant American position that accounting practices and the role of the auditor were central to the misconduct in the American corporate governance scandals and analyze how the current and expected Canadian regulatory and legislative response, with its focus on imposing liability, will make auditors losers in the corporate governance arena.  

I. CORPORATE GOVERNANCE

Berle and Means' conclusions and concerns about the separation of ownership and control in large publicly held corporations are as relevant today as they were in 1932. The separation of ownership and control causes concerns that managers will act in their own interests rather than in the best interests of shareholders. In order to reduce the divergence of interests between those who control (managers) and those who own (shareholders), an array of legal rules and market mechanisms are employed. Market mechanisms include the market for corporate control and the market for managers. Mandatory legal rules, such as the duty of care and the duty of loyalty, also act to reduce the divergence of interests between managers and shareholders. In addition, liability rules and the threat of shareholder litigation serve to reduce the divergence of interests between managers and shareholders. Managers, directors and officers can be sued by investors and are personally liable for certain corporate and securities law violations. Liability is imposed not only on managers, but on a group of people often referred to as gatekeepers, i.e. auditors, lawyers and underwriters, all of whom

4. This prediction was made by Paskell-Mede and Blackier four years ago. They predicted that there will be less of a concern with "liability in an indeterminate amount for an indeterminate time to an indeterminate class" as auditors begin to take on new forms of work and accordingly choose whether or not to engage in indeterminate liability. The authors predicted that this will influence legislatures and the judiciary to expand liability and while doing so they will be able to take comfort that the creation of measures such as limited liability partnerships and developments in the area of proportionate liability will meet the needs of auditors. See J. Blackier and M. Paskell-Mede, "Auditor Liability in Canada: The Past, Present and Future" (1999), 48 U.N.B. L.J. 65 at p. 75.


perform critical functions for a company that wishes to issue securities in the public capital markets. An issuer company must often use the services of these gatekeepers to access public capital markets. Underwriters are often necessary to assist in the distribution of securities, and lawyers are often called upon to provide legal opinions.

Auditors in particular play a specific role as gatekeepers to access of public markets. Public companies are required by corporate and securities laws to appoint an auditor to review and certify their financial statements. The auditor’s role in corporate governance is to ensure a greater degree of accountability of management to shareholders. The auditor’s role is to review the financial statements prepared by a company’s management. The primary purpose of the auditor is to bridge the information and credibility gaps that exist between top corporate management and stakeholders such as shareholders, potential investors and creditors, who are financially interested in the capital controlled by such management. The rationale for imposing personal liability on gatekeepers such as auditors is that they have an opportunity to catch misconduct or prevent issuer companies from engaging in misconduct before actual harm is caused in the marketplace.

In order to give meaning to the auditor’s role as an objective third-party scrutineer, an auditor’s independence from her clients is one of the hallmarks of the accounting profession. Independence ensures that the auditor will be objective when obtaining, reviewing and reporting client information. Canadian corporate law attempts to give the principle of auditor independence bite by requiring, for example, that:

1. the auditor is independent from the corporation;
2. the shareholders, not management, have the legal authority to appoint the auditor at the annual general meeting;
3. the auditor must report on the financial statements before the shareholders at the annual general meeting;
4. the auditor can demand all relevant information and access

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8. See Puri, supra, footnote 6, for an in-depth discussion of this issue.
9. Ibid.
10. CBCA, s. 161(1) and (2).
11. CBCA, s. 162(1).
12. CBCA, s. 171(7) and (8).
to documents necessary to enable her to make the examination;\(^{13}\)
and

(v) if the management removes the auditor or if the auditor resigns, the former auditor is entitled to speak at the next annual general meeting to disclose to shareholders and the new auditor the reasons for disagreement and the termination of the relationship.\(^{14}\)

Despite the presence of these safeguards in corporate and securities law statutes, the practical reality of the role of the auditor in corporate governance in Canada has been starkly different. Although auditors are officially appointed by the shareholders, the management of publicly held corporations selects the auditor. Shareholders have little or no input in the matter, in the same way that shareholders have little or no input in the composition of the slate of the board of directors. Auditors work closely with and are paid by management, not shareholders. Based on this close working relationship, management may also provide auditors with lucrative contracts with respect to their non-auditing services. These factors bring into question the degree of independence of auditors. Auditors have also been reluctant to report on perceived management misconduct because they did not want to be known as the whistleblowers in the corporate community.

II. LIABILITY CRISIS

In the context of a healthy, robust economy, the end of the twentieth century witnessed increased concern about the personal liability that was being placed on directors and officers, as well as gatekeepers such as lawyers, underwriters and, most notably, auditors. This concern overlay a broader perception that shareholder or investor litigation was misused or, at a minimum, overused. There were concerns about a liability crisis, an insurance crisis, and the strategic search for deep pocket defendants. There were also concerns about a flood of strike suits, multi-million dollar class actions, and frivolous and vexatious lawsuits being filed.\(^{15}\) Overall, there was a view that personal liability for corporate

\(^{13}\) CBCA, s. 168(1).

\(^{14}\) CBCA, s. 168(2).

\(^{15}\) It was claimed that by 1994, at least $1.3 billion of unresolved claims were pending against Canadian accountants. This represented a substantial increase in a short period of time. See Gundi Jeffrey, “Accountants Want Relief from Legal Nightmare”, The Financial Post (April 29, 1994), p. 12.
management and gatekeepers was too broad and that the threat of shareholder litigation was an ineffective or too-blunt tool for ensuring accountability of management to shareholders.

The response to the so-called liability crisis came from three fronts in Canada: (i) judicial narrowing of the auditor’s duty of care, (ii) the rise of limited liability partnerships, and (iii) the introduction of a proportionate liability scheme under the CBCA. All three responses can be traced to strenuous efforts mounted by the accounting profession, often with little input from other stakeholders, which we will refer to as outsiders.

The judiciary in Canada actively narrowed the auditor’s duty of care. In particular, in 1997 in *Hercules Management Ltd. v. Ernst & Young* the Supreme Court of Canada constricted the scope of the duty of care owed by auditors to shareholders and other users of audited financial statements. The plaintiffs were shareholders in Northguard Acceptance Ltd. and Northguard Holdings Ltd., companies engaged in commercial and real estate lending. Ernst & Young was the Northguard companies’ auditor. In 1984, both Northguard companies went into receivership and a suit was brought claiming that the shareholder plaintiff relied on the 1980-82 auditor reports, which were prepared negligently. The shareholder was unsuccessful in this action. The court acknowledged that there were reasonable arguments in favour of broad auditor liability, but then went on to give more weight to the policy considerations in favour of limiting auditor liability. The court reasoned that a shareholder could not bring an action against an auditor for reliance on audited financial statements for the purpose of making personal investment decisions when the purpose of the audit was to oversee the corporation’s management, not to assist individual shareholders. At the forefront of the court’s mind was the concern for “liability in an indeterminate amount for an indeterminate time to an indeterminate class”.

The second notable development in response to the liability crisis in Canada has been the advent of limited liability partnerships (LLPs). Prior to the development of LLPs, accountants and other professionals practicing in partnerships in Canada were personally liable for the negligence of their partners. LLP legislation was first enacted in the United States in the late 1980s and early 1990s as a result of the savings and loan crisis. In Canada, LLP legislation was first enacted in Ontario in 1998, followed by other provinces in subsequent years. LLPs limit the liability of professionals who practice in partnerships such that a partner in, for example, an accounting firm carried on as a LLP is no longer personally liable for the negligence of his or her co-partners. The partner still remains personally liable for his or her own negligence as well as that of anyone under his or her supervision or control.

The third and most recent development that has reduced the scope of auditor liability is a move away from joint and several liability to proportionate liability under the CBCA. The perception of many in the accounting profession was that the introduction of LLPs protected individual non-negligent partners of an accounting firm but did not help the firm itself.

The 2001 CBCA amendments that came into force on November 24, 2002 changed the regime of joint and several liability among co-defendants to a modified proportionate liability regime. In short, a defendant who is found responsible for a financial loss that arises

19. All 50 states have modified their partnership statutes to permit general partnerships to register as LLPs. See J. William Callison and Allan W. Vestal, “They’ve Created a Lamb with Mandibles of Death: Secrecy, Disclosure, and Fiduciary Duties in Limited Liability Firms” (2002), 76 Ind. L.J. 271 at p. 313, note 2, as cited in Puri, ibid., at p. 2.
22. Ibid.
out of an error, omission or misstatement in financial information that is required by the CBCA is liable to the plaintiff only for the portion of damages corresponding to the defendant's degree of liability. The new proportionate liability scheme is limited in several ways. First, the 2001 amendments only apply to misconduct in relation to the CBCA, and accordingly not to securities law breaches. Secondly, joint and several liability continues to apply in cases of fraud. Furthermore, in situations where one of the defendants (such as the issuer company) is insolvent or unavailable, there is provision for the court to apportion that defendant's liability to the other co-defendants up to a cap equal to 50% of the amount originally awarded against the co-defendant. As well, certain "unsophisticated" plaintiffs are excluded from this regime, including Crown corporations, certain charitable organizations, unsecured trade creditors in respect of goods and services that the creditor provided to the corporation, and individual plaintiffs whose investment is less than $20,000. Such unsophisticated plaintiffs, or sophisticated plaintiffs who make small investments, can continue to collect under the joint and several liability regime. Finally, courts are left with the option to award joint and several liability where it is just and reasonable to do so.

The benefits of proportionate liability are not limited to auditors. Corporations, officers, directors, lawyers and other co-defendants can take advantage of this new liability scheme. However, as with the introduction of LLPs in Canada, the accounting profession was the driving force behind the introduction of this set of changes to the CBCA. The dominant argument in favour of the changes made by the accounting profession was that joint and several liability was unfair. For example, under a regime of joint and several liability, auditors complained that they might have only been responsible for 5% of the plaintiff's losses, but ended up paying out 100% of the

26. CBCA, s. 237.3(1).
27. CBCA, s. 237.1.
28. CBCA, s. 237.4(1).
29. CBCA, s. 273.3(4).
30. CBCA, s. 237.2(2).
31. CBCA, s. 237.5(1).
32. CBCA, s. 237.5(2).
33. The Estey Brief on the liability facing the audit profession was the driving force behind both the implementation of LLPs in Canada and the proportionate liability in the CBCA: The Hon. W.Z. Estey, Q.C., "Proportionate Liability and Canadian Auditors", Brief Prepared for Legal Liability Task Force, Canadian Institute of Chartered Accountants (January 23, 1996). See also W. Gray and C.W. Halladay, supra, footnote 23, at p. 62.
damages because the issuer company, which was 95% responsible, was insolvent at the time of the action. The Report of the Standing Committee on Banking Trade and Commerce on Joint and Several Liability and Professional Defendants, chaired by the Honourable Michael Kirby, set out this concern as follows:

The principal argument against maintaining joint and several liability is also based on fairness — fairness to the defendants. It is argued that it is unfair that a defendant whose degree of fault is minor when compared to that of other defendants should have to fully compensate a plaintiff if the other defendants are insolvent. In theory, the less blameworthy defendants can recover from the more blameworthy defendants; in practice, however, the former, particularly where they are insured professionals, are left to bear the lion’s share of liability when other defendants are insolvent or have disappeared. 34

The introduction of the new proportionate liability scheme is fraught with difficulties. It is beyond the scope of this article to dwell upon the issues of drafting and judicial resources that will be expended to interpret the amendments, or the potential unconstitutional encroachment on the powers of the provinces to legislate on this matter.

However, we do question the preferential treatment that Crown and charitable organizations receive under the scheme, given that the former certainly cannot qualify as an unsophisticated investor and the latter is a heterogeneous class of organizations of varying levels of sophistication. We also wonder why $20,000 was chosen as the threshold beyond which an individual investor would be denied joint and several recovery against defendants. Finally, we are concerned that the long-awaited statutory civil liability scheme for continuous disclosure violations that has been proposed in Ontario by way of amendments to the Securities Act contains its own proportionate liability scheme that operates on an entirely different basis from that in the CBCA. 35 It would have been judicious to achieve some level of harmonization, or at least consistency, on this important liability issue.

Most significant to this article are concerns relating to process and the current climate for a new proportionate liability scheme. In a manner reminiscent of the introduction of LLPs in Canada, 36

34. Standing Senate Committee on Banking, Trade and Commerce, Joint and Several Liability and Professional Defendants (March 1998), at p. 2.
35. See infra, footnotes 52 to 57 and accompanying text.
36. Puri, supra, footnote 18.
there was a lack of meaningful debate from the perspectives of the multiple stakeholders affected by the changes to the CBCA. Members of the accounting/auditing profession made submissions to the Standing Committee on Trade Commerce and Finance, but there was a lack of representation on the part of investors/shareholders of corporations. Perhaps if there had been more debate and a more inclusive process we would not be in the situation that we are in today where: (i) we have legislation that is inconsistent with the current economic climate, and (ii) a number of North American corporate governance scandals have surfaced which have at their root accounting problems and problems with the role of the auditor as gatekeeper.

III. AUDITOR LIABILITY IN THE CONTEXT OF THE CURRENT CORPORATE GOVERNANCE CLIMATE

In our view, the narrowing of the scope of auditors' liability is not a positive development for corporate governance. The threat of shareholder litigation acts both as an incentive for managers to remain accountable to investors and for gatekeepers to perform their gatekeeping function effectively. We believe that the response to the so-called liability crisis, which resulted in a reduction of auditor liability on many fronts, has assisted in creating an environment in which auditors have not performed their gatekeeping function effectively, have been lax about their conflicts of interest, have succumbed to management pressure to approve financial documents in a certain way, and overall have not performed their jobs of being independent scrutineers of financial documents prepared by management. Evidence and support for these claims come from recent incidents south of the border.

It is clear that misleading and fraudulent accounting practices and policies were at the heart of the recent American corporate scandals. It is difficult to separate the role and responsibility of the auditor from that of management in financial matters unless management clearly withheld information from the auditors. John Coffee argues that Enron must be viewed as evidence of systematic governance failure in the United States, due in large part to the changing status of the auditor gatekeeper.\(^\text{37}\) The story of the decline of auditor liability in the United States in the 1990s, combined with

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37. Coffee, supra, footnote 7.
the increased incentives to defer to management (such as lucrative consulting contracts), can be easily mapped on to a similar story in the Canadian context, albeit at a slower pace. Coffee points to judicial and legislative change in the United States in the 1990s, which collectively reduced the liability of auditors, and the onset of the Big Five accounting firms using their audit function principally to cross-sell lucrative consulting services.38

Today, as a result of the recent corporate governance scandals, we have seen and continue to see an expansion of liability as a governance tool in both Canada and the United States. In particular, there has been and will continue to be a tightening of rules under which the auditor operates as a gatekeeper to the securities markets. The actual and anticipated regulatory response in Canada and the United States has focused on personal liability for top management through the use of CEO/CFO certification of financial disclosure; increased independence of directors on corporate boards; changes to the composition, role and responsibilities of audit committees; and a restructuring of the relationship between auditors and corporate managers.

In the United States, the Securities and Exchange Commission (SEC) has adopted final rules under Title II of the Sarbanes-Oxley Act of 200239 that impose new independence requirements for accounting firms conducting audits of a reporting company’s financial statements.40 The new rules, effective May 6, 2003, provide a number of provisions that address issues relating to the role and performance of auditors. In particular, SOX restricts the services that auditors can provide contemporaneously with the audit.41 Any permitted non-audit services must be approved in advance by the audit

38. Coffee, ibid.
40. SEC Release Nos. 33-8183; 34-47265; 35-27642; IC-25915; IA-2103; FR-68 (January 28, 2003). See <http://www.sec.gov/rules/final.html> (accessed March 16, 2003). We recognize that the independence rules adopted by the SEC are not just the concern of auditors; however, we limit our comments to the confines of this article concerning auditor liability. If there is an independence problem it will have serious liability consequences not just for the auditor but for the audit committee that approves the services, the CEO or CFO who will be required to certify the services, and the company more generally. Pursuant to s. 302 of SOX, the SEC is required to adopt rules that require CEOs or CFOs to certify the: (i) fairness of presentation of the company’s financial statements, (ii) adequacy of the company’s internal controls and (iii) adequacy of the company’s disclosure controls and procedures.
41. Pursuant to SOX, s. 201:
   An auditor of a public company that performs any audit will be prohibited from providing any non-audit services, including:
   a. Bookkeeping services;
committee of the audit client. The lead audit partner, or the audit partner responsible for reviewing the audit, must be rotated at least every five years. A public accounting firm cannot provide services to an issuer if certain officers of the company were employed by the accounting firm in the year prior to the audit.

The SEC has also adopted final rules under s. 802 of SOX that require an accounting firm to retain its records for a period of seven years following the completion of an audit or review of a reporting company's financial statements. Notably, the SEC has adopted a separate rule under s. 10A of the Securities Exchange Act of 1934 that not only makes it unlawful for an auditor not to be independent under the relevant SOX rules but also opens auditors up to additional liability under the 1934 statute.

Unlike the situation in the United States, in Canada jurisdiction over securities law is fragmented, with multiple regulatory bodies involved in the process of reform without real harmonization. A vigorous debate has been taking place among Canadian securities regulators and stock exchanges on what a made-in-Canada corporate governance solution should look like. Some regulators, such as the British Columbia Securities Commission, have suggested that the newly heightened U.S. rules present a competitive opportunity for attracting companies to Canada, while other regulators such as the Ontario Securities Commission (OSC) fear capital flight if our standards are not raised to U.S. levels. The OSC's argument is that there is no quick profit to be made from failing to protect investors,

b. Financial Information systems design and implementation;
c. Appraisal or valuation services, fairness opinions, or contribution in kind reports;
d. Actuarial services;
e. Internal audit outsourcing services;
f. Management functions or human resources;
g. Broker or dealer, investment adviser, or investment banking services;
h. Legal services and expert services unrelated to the audit; and
i. Any other services that the PCAOB determines is impermissible.

42. SOX, s. 202.
43. SOX, s. 203.
44. SOX, s. 206.
47. In the fall of 2002, OSC Chair David Brown invited market participants to engage in a debate on an appropriate regulatory response. See, for example, response letter of Barbara Stymiest, CEO of the TSX, to David Brown, Chair of the Ontario Securities Commission (September 17, 2002), available at <http://www.osc.gov.on.ca/en/HotTopics/prom_inv_conf.html#expanded>.
48. See letter of Barbara Stymiest, ibid.
with the downside being a decline in the ability to attract capital to Canada. It may be that the made-in-Canada response that is currently being tailored may involve only the OSC and Toronto Stock Exchange (TSX) adopting modified versions of the American reforms, while other provincial securities regulators and the TSX Venture Exchange stay put with their existing levels of regulation.

In addition to the regulatory efforts from within the accounting profession and the formation of the CPAB, discussed earlier, we focus below on the response from the Ontario Securities Commission and the TSX, which the OSC oversees in its role of supervising regulatory organizations and recognized exchanges.

On October 30, 2002 the Ontario Minister of Finance, as part of the Government’s Fall 2002 Budget Bill, introduced proposed amendments to the Ontario Securities Act. The proposed amendments are included in Bill 198, Keeping the Promise for a Strong Economy Act (Budget Measures), 2002. Bill 198 received Royal Assent on December 9, 2002, and the changes to the OSA discussed below have not yet been proclaimed into force.

Bill 198 creates express prohibitions against securities fraud, market manipulation and making misleading or untrue statements. Further, Bill 198 creates a statutory right of action for investors in the secondary market to sue companies and other responsible persons for misrepresentations or failure to make timely disclosure. This proposed civil liability scheme is based on draft legislation previously published by the Canadian Securities Administrators, which arose out of the Toronto Stock Exchange Committee on Corporate Disclosure’s final report issued in March 1997. Ontario is the first province to introduce the proposed legislation.

The new scheme for civil liability creates a right of action against (i) the responsible issuer, (ii) the person making the public

49. The TSX Group operates two exchanges: the TSX itself and the TSX Venture Exchange. Only the TSX is under the Ontario Securities Commission’s regulatory jurisdiction. For the purposes of this article we focus only on the TSX.

50. Pursuant to the Securities Act, R.S.O. 1990, c. S.5 (hereafter OSA), s. 21(2), the OSC may, on the application of a person or company proposing to carry on business as a stock exchange in Ontario, recognize the person or company if the OSC is satisfied that to do so would be in the public interest. The TSX was recognized by the OSC as a stock exchange pursuant to Recognition Order 21-901.

51. OSA, ss. 126.1 and 126.2.

52. OSA, s. 138.13.

oral statement, (iii) each director or officer of the responsible issuer, (iv) an influential person, (v) each director or officer of the influential person, and (vi) each expert. “Expert” is defined to include auditors.

Interestingly, Bill 198 adopts a proportionate liability scheme. However, it differs from the one adopted under the CBCA. Similar to the scheme under the CBCA, it limits the damages payable by a defendant to the proportionate share of its responsibility for the harm, up to caps that are specified in the legislation. However, unlike the CBCA amendments, which allow certain plaintiffs to continue to use joint and several liability, this scheme permits all plaintiffs to recover on a joint and several basis from particularly blameworthy defendants. Where a court determines that a particular defendant knowingly authorized, permitted or acquiesced in the making of the misrepresentation, or the failure to make timely disclosure, the whole amount of the damages assessed in the action may be recovered from that defendant on a joint and several liability basis.\(^5\)

Under the scheme in Bill 198, the maximum liability for an auditor would be limited to the greater of a million dollars and the revenue that the auditor and any of its affiliates have earned from the responsible issuer and its affiliates during the 12 months preceding the misrepresentation.\(^5\) As noted above, the liability limits do not apply where the plaintiff proves that the auditor knowingly authorized, permitted or acquiesced in the making of the misrepresentation or the failure to make timely disclosure.\(^5\)

In addition to Bill 198, the OSC has been working with the TSX Group,\(^5\) which operates the TSX, to develop new rules for public companies listed on the TSX. The recently amended Ontario Securities Act also authorizes the OSC to make rules on the composition, role and responsibilities of the audit committee.\(^5\) On July 27, 2003,

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54. OSA, s. 138.6(2).
55. The liability limit for each category of individual or person is specified in the definition for “liability limit” under OSA s. 136.1.
56. OSA, s. 138.6(2).
57. Pursuant to OSA s. 21(5), the OSC may, if it appears to be in the public interest, make any decision with respect to any by-law, rule, regulation, policy, procedure, interpretation or practice of a recognized stock exchange.
58. See Notice of Request for Comments <www.osc.gov.on.ca/en/Regulation/Rulemaking/Rules/rule-52-108-20030627-C1notice-roc.pdf> (accessed August 29, 2003) (hereafter Multilateral Instruments). The TSX has also released Proposed Amended TSX Corporate Disclosure Guidelines, which are currently under consideration by the OSC and not in force. However, these guidelines are weaker than the Multilateral Instruments. See
the OSC published for a 90-day comment period Multilateral Instruments 52-108 (Auditor oversight), 52-109 (Certification of Disclosure in Companies’ Annual and Interim Filing). The guidelines currently in force can be found in the Toronto Stock Exchange Company Manual.59

Currently, the TSX Manual provides that the board of directors should adopt a charter for the audit committee that sets out the roles and responsibilities of the committee so as to provide guidance to the committee members as to their duties.60 The Multilateral Instruments would go further to require that all of the TSX’s listed issuers have an audit committee with a proper charter.61 Currently, the TSX Manual recommends that an audit committee be composed of only unrelated directors.62 The Multilateral Instruments would make it a requirement that audit committees are composed of independent directors.63 The Multilateral Instruments would also require that all members of audit committees be financially literate.64 The Multilateral Instruments are fueled by the recognition that audit committees exist primarily to enhance the external auditor’s independence.

IV. CONCLUSION

We have made the case that despite recent amendments to the CBCA implementing a proportionate liability scheme that will apply to auditors, in the future auditors will be losers when it comes to limiting their liability through statutory and judicial mechanisms. This article has mapped the Canadian pattern of reducing auditor liability through judicial pronouncements narrowing the scope of their duty of care, the creation of LLPs and the introduction of proportionate liability. We have suggested that a similar pattern unfolded in the United States, albeit at a faster pace, such that Canada did not fully experience the negative impact these changes had on the auditor gatekeeping function.

60. TSX Manual, ibid., s. 473(13).
62. TSX Manual, supra, footnote 59, s. 473(13).
At the same time, by illustrating the extent to which Canadian federal and provincial regulators have focused on auditors and their role as gatekeepers to prevent an Enron in Canada, this article has illustrated the pivotal role that auditors and audit committees have in preserving investor confidence in the post-Enron era. This may be a role that auditors can capitalize on in Canada, but only if they truly understand the nature of their potential liability in the future. In the United States, Enron was a landmark event, not in the nature of the corporate practices that were exposed, but in terms of the significant legislative changes and the new rules adopted by the SEC, all relating to and creating a renewed interest in the role of auditors. In Canada, auditors have the benefit of this reaction from regulators and legislatures ex ante, better equipping them for taking on the task of playing a renewed pivotal role in investor confidence at a time when all stakeholders are taking corporate governance seriously.