

Case Name:

Sherman v. Orenstein & Partners

Between

**Dr. Bernard Sherman, appellant, and
Orenstein & Partners, Peter Browning and Albert Title,
respondents**

[2005] O.J. No. 5161

205 O.A.C. 75

11 B.L.R. (4th) 233

144 A.C.W.S. (3d) 363

2005 CarswellOnt 6995

Docket: C40739

Ontario Court of Appeal
Toronto, Ontario

J.I. Laskin, E.A. Cronk and E.E. Gillese JJ.A.

Heard: April 1, 2005.

Judgment: December 2, 2005.

(79 paras.)

Professional responsibility -- Professions -- Other -- Accountants -- Appeal by plaintiff from dismissal of negligence action, reported at [2003] O.J. No. 3361 and [2004] O.J. No. 782, dismissed -- Trial judge did not err in statement and application of standard of care.

Tort law -- Negligence -- Standard of care -- Appeal by plaintiff from dismissal of negligence action, reported at [2003] O.J. No. 3361 and [2004] O.J. No. 782, dismissed -- Trial judge did not err in statement and application of standard of care.

Appeal by the plaintiff, Sherman, from the dismissal of his action against the defendant accounting

firm, Orenstein & Partners, for damages for negligence and negligent misrepresentations in the preparation of financial statements. Sherman, an astute investor, was the only limited partner in two of 79 limited partnerships promoted by Bellfield for the purpose of acquiring and chartering offshore luxury yachts. The partnerships were marketed to investors in Canada as tax shelters. The firm was retained in 1985 to provide a tax opinion and a review engagement in connection with the limited partnerships. Following an audit, all of the tax deductions claimed by Sherman in connection with the limited partnerships were disallowed. Bellfield was convicted of fraud and it was accepted that the limited partnerships were shams. Sherman argued that had the firm attached a "going concern" note to its report, he would have been alerted to the fact that the limited partnerships were unlikely to become operating businesses. Sherman's action against the firm was dismissed. The trial judge found that the firm did not breach its duty of care to Sherman because the professional standards relating to review engagements prior to 1989 involved questions of judgment on which careful and reasonable chartered accountants might differ significantly. Sherman appealed on the basis that the judge applied the wrong standard of care and erred in concluding that the failure to attach a going concern note was inconsequential.

HELD: Appeal dismissed. The trial judge did not misstate the applicable standard of care. In addition, Sherman failed to establish that the judge erred in concluding the firm did not breach the required standard of care. The judge was entitled to find that the reviewing accountants asked proper questions of management, received plausible answers, and acquired no information that called for further enquiries. Thus the findings that the firm was not negligent in its review, or in its decision not to append a going concern note, were not made in error. Moreover, the findings that Sherman would not have noticed a going concern note, or would have disregarded it, were not palpable and overriding errors. The judge's findings were supported by the evidence and entitled to deference.

Appeal From:

On appeal from the judgment of Justice Maurice Cullity of the Superior Court of Justice dated September 3, 2003 made at Toronto, Ontario.

Counsel:

Donald H. Jack and Jasmine Akbarali for the appellant

Nina Perfetto and Toshi **Takishita** for the respondent

The judgment of the Court was delivered by

J.I. LASKIN J.A.:--**A. OVERVIEW**

1 The issues in this lawsuit are whether the respondent chartered accounting firm, Orenstein & Partners ("Orenstein"), breached the standard of care required of it in performing a review engagement; and, if so, whether its breach caused the loss claimed by the appellant Bernard Sherman.

2 Sherman is an astute businessman, an experienced investor, and the chair of Apotex Inc., Canada's largest generic drug manufacturer. In the mid 1980s, Sherman invested in two tax shelters by purchasing all the units of two Limited Partnerships: the Great Gatsby and Elegance. These and seventy-seven other similar limited partnerships were formed to invest in luxury sea-going yachts. Overseas Credit and Guarantee Corporation ("OCGC") was the general partner of all the limited partnerships.

3 OCGC loaned Sherman the money to buy the units in Gatsby and Elegance. Sherman made monthly interest payments on the loans, which he deducted along with other expenses and losses for Gatsby and Elegance on his income tax returns for 1985-89.

4 The Limited Partnerships turned out to be a sham. They did not conduct the business they claimed to conduct. OCGC became insolvent and its principals were convicted of fraud. After an audit, Revenue Canada disallowed the tax losses and interest deductions that Sherman had claimed for the years 1985-88.

5 Orenstein performed review engagements of the financial statements of twenty-two of the limited partnerships, including Gatsby and Elegance. The respondent Albert Title, a partner at the firm, did the work. The respondent Peter Browning, another partner, reviewed Title's work and also did some accounting and tax work for OCGC.

6 Sherman sued the respondents for negligence. He claimed that they negligently failed to include in the financial statements of Gatsby and Elegance a "going concern" note. He claimed this note would have alerted him that the Limited Partnerships would not likely become operating businesses. He alleged that had the respondents included a going concern note, he would have stopped making interest payments much sooner than he did. He quantified his loss at more than \$600,000.

7 In comprehensive reasons, Cullity J. dismissed the action. He concluded that the respondents did not breach the standard of care required for a review engagement. He also concluded that even if the respondents had included a going concern note, Sherman either would not have noticed it, or, if he did, would not have stopped making interest payments.

8 Sherman appeals. As I understand his argument, he essentially makes four submissions: two relating to the standard of care, and two relating to causation. They are:

- (1) The trial judge erred in law by applying the wrong standard of care for a review engagement;
- (2) The trial judge erred in concluding that the respondents were not negligent in failing to include a going concern note in the 1987 financial statements of Gatsby and Elegance;
- (3) The trial judge committed a palpable and overriding error in concluding that Sherman would not have noticed a going concern note; and
- (4) The trial judge committed a palpable and overriding error in concluding that even if a going concern note had been included in the financial statements of Gatsby and Elegance, Sherman would not have stopped making interest payments earlier than he did.

9 For the reasons that follow, I have concluded that all of Sherman's submissions must fail.

B. FACTUAL BACKGROUND

(a) The Limited Partnerships

10 The limited partnerships were formed to acquire and build luxury sea-going yachts, charter them to yachting parties in the Mediterranean and Caribbean Seas, and earn income from the charter revenues.

11 The general partner, OCGC, was responsible for financing the limited partnerships. Related companies were responsible for building, managing, and assisting in the financing of each yacht. Einar Bellfield, the architect of the scheme, had an interest in all these companies.

12 OCGC marketed the limited partnerships as tax shelter investments. OCGC loaned investors the money needed to purchase units in the limited partnerships. The investors made monthly interest payments on the loan, and deducted those payments along with "soft cost" and losses from their income.

(b) Sherman purchases the units of Gatsby and Elegance

13 Gatsby was formed in 1985. Sherman acquired all the Gatsby partnership units in December 1985. However, he was not satisfied with the documentation. He refused to close the transaction until April 29, 1986, when he reached a settlement agreement with OCGC and Bellfield. Under the terms of that agreement, OCGC and Bellfield guaranteed any deficiency in Sherman's expected tax write-offs and gave him the right to set off the deficiency against his monthly interest payments.

14 Elegance was formed in 1986. Sherman acquired all the units in Elegance in December 1986.

15 The Gatsby and Elegance offering memoranda each contemplated the purchase or construction of a yacht for use in the chartering business. No yacht was ever acquired or built.

16 From January 1, 1986 to December 31, 1989 (when he stopped paying OCGC), Sherman made monthly interest payments on his Gatsby loan in the amount of \$12,999.84. From January 1, 1987, to December 31, 1989, Sherman made monthly interest payments on his Elegance loan in the amount of \$18,750.00. He deducted these payments on his annual income tax returns.

(c) Title's work on the review engagements

17 Title did the annual review engagements for the financial statements of Gatsby and Elegance. He performed the work each spring.

18 His work consisted of the following: he reviewed the files to gain a working knowledge of the Limited Partnerships and he reviewed feasibility studies on the yachting business; he met with the general partner to discuss and question the trial balances of the partnerships; he asked the general partner for bank reconciliation statements, copies of invoices and communications to investors; and he asked questions relating to his review to determine the plausibility of the answers he had received.

19 In March 1988, Title considered whether he should add a going concern note to the 1987 financial statements of Gatsby and Elegance. After a discussion with Browning, he decided that a going concern note was not warranted. He had no reason to believe that Gatsby and Elegance were likely to fail.

(d) The Revenue Canada audit

20 In May 1987, Revenue Canada began an audit of OCGC and the limited partnerships. The respondents knew about the audit. Browning dealt with Revenue Canada on behalf of OCGC. As a result of its audit, Revenue Canada disallowed Sherman's tax write-offs for Gatsby and Elegance, and reassessed his income tax returns. I will briefly summarize what occurred.

21 In late August 1987, Revenue Canada wrote Sherman to advise him that his 1986 income tax return would not be processed until the audits of Gatsby and Elegance were completed. In October 1987, OCGC sent a memorandum to its limited partners, including Sherman, advising them of the Revenue Canada audit.

22 In July 1988, Revenue Canada wrote Sherman to advise him that his 1987 income tax return would not be processed until the audits of Gatsby and Elegance were completed.

23 In May 1989, Revenue Canada concluded that the businesses of the limited partnerships had no reasonable expectation of profit. On June 15, 1989, Revenue Canada wrote Sherman to tell him that his 1985, 1986, and 1987 income tax returns would be reassessed, and that his claims for partnership losses, interest expenses, and other costs related to Gatsby would be disallowed. Revenue Canada's letter said that "the general partner failed to demonstrate that the partnership was properly constituted and carrying on a business," and that the loans given by OCGC appeared "to

have no substance and in any event were not laid out to earn income."

24 In July 1989, Revenue Canada wrote Sherman to tell him that his 1988 income tax return would not be processed until the audits of Gatsby and Elegance were completed.

25 In June 1991, Revenue Canada wrote Sherman to tell him that his 1986, 1987, and 1988 income tax returns would be reassessed, and that his claim for partnership losses, interest expenses, and other costs related to Gatsby and Elegance would be disallowed again because OCGC had failed to demonstrate that "Gatsby and Elegance were properly constituted and carrying on business" or that "related interest expense and other costs were laid out to earn income."

(e) Sherman's income tax returns are reassessed and he settles with Revenue Canada

26 In December 1990, Revenue Canada issued a notice of reassessment for Sherman's 1985 income tax return. He filed a notice of objection. In March 1992, Revenue Canada issued notices of assessment for the 1986, 1987, and 1988 taxation years. Again, Sherman filed notices of objection.

27 In June 1996, Sherman settled his tax appeals with Revenue Canada. He agreed that his write-offs and losses for Gatsby and Elegance would be disallowed; Revenue Canada agreed to waive interest and to refund the interest arrears that Sherman had paid.

(f) Sherman's claim

28 Sherman sued the respondents for twenty monthly interest payments he had made to OCGC. He claims he would not have made these payments had the respondents included a going concern note in the financial statements for Gatsby and Elegance. Sherman claims that the respondents should have added this note in the 1987 financial statements, and that he would have seen that note in the spring of 1988. He therefore seeks damages equivalent to his monthly interest payments from May 1988 until December 1989, when he stopped making payments: a total of \$634,996.80.

(g) The Scace Report

29 In August 1990, the limited partners retained Arthur Scace to report on the Revenue Canada audit. Scace retained Title to make further enquiries of OCGC and its financing. After making these enquiries, Title determined that no financial arrangements existed for the acquisition of yachts from the builder; that no financial arrangements existed for the management of the yachting ventures; and that though it was paying interest to a related financing company, OCGC had never actually borrowed money from that company.

C. ANALYSIS

1. Did the trial judge err in law by applying the wrong standard of care for a review engagement?

30 Orenstein prepared the annual financial statements for twenty-two of the limited partnerships under what the accounting profession calls a "review engagement." As I have said, Title considered including a going concern note in the 1987 financial statements of Gatsby and Elegance, but after a discussion with Browning determined that one was not warranted. Sherman argued that in failing to include a going concern note, the respondents fell below the standard of care required of an accountant doing a review engagement. The trial judge held that the respondents owed Sherman a duty of care, but he also held that they had met the standard of care required of them.

31 Sherman submits that in so holding, the trial judge erred in law by applying the wrong standard of care. His submission has two branches: the trial judge wrongly held that the standard is sufficiently vague and elastic to make differences of opinion inevitable; and the trial judge misstated what information ought to trigger an accountant's further enquiries and decision to include a going concern note. I do not accept either branch of this submission.

(a) The standard of care required for a review engagement

32 The standard of care required of an accountant performing a review engagement has already been canvassed by my colleague MacPherson J.A. in *Bloor Italian Gifts Ltd. v. Dixon* (2000), 48 O.R. (3d) 760 (C.A.). I do not intend to repeat his thorough discussion of that standard. I will simply summarize the principles relevant for this appeal.

33 First, the Canadian Institute of Chartered Accountants' Handbook (CICA Handbook) is a persuasive guide to the applicable standard of care.

34 Second, the CICA Handbook¹ stipulates that a review engagement has a limited objective: the accountant must assess the information reported on against the standard of plausibility. The Handbook states that a review engagement consists "primarily of enquiry, analytical procedures and discussion related to information supplied to the public accountant by the enterprise with the limited objective of assessing whether the information being reported on is plausible within the framework of appropriate criteria." "Plausible" means "appearing to be worthy of belief." See *Bloor Italian Gifts* at para. 28. An accountant has an obligation to make further enquiry only if the information supplied by management casts doubt on its plausibility.

35 A review engagement is therefore less demanding than an audit. Unlike an audit, an accountant doing a review engagement does not undertake to verify the accuracy of the information provided by the client. Instead, the accountant assumes that the client is telling the truth.

36 Third, although an accountant performing a review engagement must have enough knowledge of the enterprise to make intelligent enquiries, the accountant's assessment of plausibility is largely a matter of professional judgment.

37 Fourth, a review engagement does not rule out the possibility of undetected fraud or error.

38 In assessing the conduct of the respondents, the trial judge applied the principles set out by MacPherson J.A. in *Bloor Italian Gifts*, including those that I have outlined. Nonetheless, Sherman submits that Justice Cullity fell into error because of the following passage in his reasons (at paras. 73-74):

I believe, also, that there is sufficient vagueness in the concept of "plausible" financial statements to make it inevitable that there would be differences of opinion in the accounting profession with respect to its interpretation generally as well as in its application to particular facts. This was borne out by the conflicting views of the experienced and well-qualified chartered accountants who gave expert evidence in this case.

The general standard applicable to review engagements must, therefore, be considered to be somewhat elastic and this - as well as the fact that errors of judgment are not necessarily negligence - must, I believe, affect the degree of latitude permitted to the accountant.

39 Sherman says that the required standard of care is neither vague nor elastic, but clear and firm. However, I see no error in the trial judge's statement. As I read his reasons, he was simply stating the obvious: plausibility is a general standard, and thus, at the margins, accountants exercising their professional judgment may differ on whether information supplied by an enterprise is or is not worthy of belief. Indeed, as the trial judge pointed out, the two experts who testified in this case - Irving Rosen for Sherman, and Laurence Rosen for Orenstein - did disagree on the plausibility of the information Title relied on. And, as the trial judge also noted, differences in professional judgment do not automatically lead to a finding of negligence.

(b) Review engagements and a going concern note

40 A "going concern" is an enterprise that will continue in business. In accountants' terminology, the enterprise neither intends to nor needs to liquidate or cease its operations within at least twelve months from the date of its balance sheet. Thus, when an accountant attaches a going concern note to an enterprise's balance sheet, the accountant alerts its readers that within the next year the enterprise is unlikely to continue to operate.

41 A going concern note is obviously a serious addition to an enterprise's financial statement. It may destroy the business of the enterprise. Accountants understandably exercise caution before including such a note.

42 Moreover, the respondents' expert Laurence Rosen testified that because the inclusion of a going concern note is so serious, it requires of an accountant the kind of enquiry that is incompatible with a review engagement. In his view, an accountant would have to "stumble over something before he would pursue it." Nothing less would trigger the kind of investigation required

before an accountant could justifiably include a going concern note in an enterprise's financial statement. The trial judge preferred Laurence Rosen's opinion on the interplay between a going concern note and a review engagement to that of Sherman's expert, because it was more "practical and persuasive."

43 Sherman argues that we should reject Laurence Rosen's opinion. Instead, he says, we should hold that an accountant doing a review engagement is required to consider adding a going concern note and that much less than a "stumble" test is required to trigger an investigation leading to the inclusion of such a note.

44 There are two answers to this argument. First, the trial judge was entitled to accept the opinion of the respondents' expert. It was, as the trial judge noted, supported by the absence of any reference to a going concern note in the section of the CICA Handbook dealing with review engagements.

45 Second, however, the trial judge still acknowledged that cases might arise where information gathered in the course of a review engagement should prompt an accountant to add a going concern note to an enterprise's financial statement. In the words of the trial judge, "however, if in the mind of a reasonable accountant, the information obtained in the course of a review would raise real doubts as to the ability of the business to continue as a going concern, I do not think such doubts could properly have been ignored." Sherman could not legitimately ask for a more onerous standard than this.

46 In my view, the trial judge applied the correct standard of care to the respondents' review engagement of the financial statements of Gatsby and Elegance.

2. Did the trial judge err in concluding that the respondents were not negligent in failing to include a going concern note in the 1987 financial statements of Gatsby and Elegance?

47 At trial, Sherman advanced two related arguments why the respondents were negligent or in breach of the standard of care required of them. They failed to make adequate enquiries in the face of "material information" or "red flags" that should have prompted these enquiries; and largely because they did not make these enquiries, they also failed to add a going concern note to the 1987 financial statements of Gatsby and Elegance.

48 The trial judge rejected these arguments. He concluded that Title asked proper questions of management, received plausible answers, and acquired no information that called for further enquiries.

49 Also, in even considering including a going concern note in the 1987 financial statements, Title arguably went beyond, but at the very least met, the standard of care required of an accountant performing a review engagement. Indeed, Sherman's expert Irving Rosen acknowledged as much. The trial judge certainly concluded that Title had exercised reasonable care and skill. I am not

persuaded of any basis to interfere with that conclusion.

50 I will nonetheless address the three errors Sherman alleges the trial judge made in coming to his conclusion. They are these: the trial judge did not take account of the information Browning possessed by virtue of his work for OCGC; the trial judge considered the so-called "red flags" individually, but did not assess their cumulative impact on the plausibility of the financial statements; and the trial judge erred by failing to hold that Title's work for Scace in 1990 was similar to a review engagement, and that therefore Title could have discovered OCGC's fraud two years earlier when it mattered to Sherman.

51 Browning apparently did not typically share information with Title. I agree with Sherman that if Browning acquired information through his work for OCGC that was relevant to the plausibility of the Gatsby and Elegance financial statements, Orenstein was bound to use that information in doing the review engagements. I do not agree, however, that Browning had any information that would have caused Title to make further enquiries.

52 Sherman focuses on two pieces of information available to Browning. Because he reviewed OCGC's draft answers to the Revenue Canada audit, Browning knew construction financing had not been drawn down; and according to Sherman, Browning knew that the 1986 financial statement of OCGC, which originally showed net earnings of \$23 million was revised drastically downwards to show a net loss of \$11.7 million.

53 The trial judge addressed both pieces of information. As the trial judge pointed out, the lack of financing was hardly a surprise. The need for financing was evident from the outset. Browning did not prepare OCGC's audited statements, and the trial judge accepted his evidence that he did not recall seeing the 1986 statement with the revised earnings figure. In addition, the trial judge accepted the evidence of Title, Browning, and Laurence Rosen that the earnings write-down was done for tax planning purposes, and did not reflect the "financial health" of OCGC.

54 The other so-called "red flags" were considered by Title, and in turn by the trial judge. They included: the Revenue Canada audit; the absence of any yacht for Gatsby; the absence of any revenues for Gatsby or Elegance; and OCGC's lack of financing.

55 By itself, the Revenue Canada audit could not be classified as a "red flag". Sherman and the respondents were well aware that investing in these limited partnerships was an aggressive form of tax planning that might attract the interest of Revenue Canada. The lack of a yacht for Gatsby, and Gatsby's consequent failure to earn income were plausibly explained by problems with the original shipbuilder and the substitution of a new builder. Elegance was not expected to earn any income until 1990. Far from being without funds, OCGC was receiving a steady flow of money in the form of interest payments.

56 In the light of the answers he received from management, Title concluded that none of these "red flags" warranted further enquiry. The trial judge agreed. To say otherwise would judge the

respondents with the benefit of hindsight.

57 Still, Sherman contends that the trial judge erred by assessing the impact of each piece of information available to Title individually, instead of cumulatively. The trial judge's reasons contradict this contention. At para. 95 of his reasons, he held:

Despite Mr. Jack's meticulous and painstaking attempts to find warning signals in an accumulation of information acquired by Mr. Title, together with that to be attributed to him through the knowledge of Mr. Browning, I do not believe that, without the benefit of hindsight, the signals were anything like as clear as counsel submitted, or that the attention and the responses they received from Mr. Title were inadequate. For these reasons, I am dismissing the claims against the defendants for negligent provision of services.

This holding completely answers Sherman's contention.

58 In 1990, Scace, on behalf of the limited partners, asked Title to investigate OCGC's finances. Title did so, and discovered that OCGC had committed fraud. Title described his mandate from Scace as "a review consisting primarily of enquiry analytical procedures and discussion relating to information provided by ... OCGC."

59 Sherman submits that Title's own description of his mandate parallels an accountant's task in doing a review engagement. Thus, Sherman argues that what Title did in 1990, he should have done in the spring of 1988. Sherman submits that the trial judge erred in failing to so find.

60 The trial judge rightly rejected Sherman's argument. Despite the language Title used to describe his mandate for Scace, as the trial judge pointed out, Title's investigation in 1990 was "more thorough and penetrating" than would be required for a review engagement. And there were two other important differences between what Title did for Scace and what Sherman wanted him to do. First, Title's work for Scace took place in 1990. The trial judge reasonably observed that it was unclear Title would have arrived at a similar conclusion two years earlier. Second, Scace asked Title to inquire into the financial ability of OCGC. That is quite different from an enquiry into the plausibility of the financial statements of the Limited Partnerships.

61 In my view, Sherman has failed to establish that the trial judge erred in concluding the respondents had not breached the standard of care required of them.

3. Did the trial judge commit a palpable and overriding error in finding that Sherman would not have noticed a going concern note?
4. Did the trial judge commit a palpable and overriding error in finding that even if a going concern note had been included in the financial statements of Gatsby and

Elegance, Sherman would not have stopped making interest payments earlier than he did?

62 The trial judge dealt with these two causation issues together, and so will I. Although the trial judge found that in failing to include a going concern note, the respondents had not fallen below the standard of care required of them, he nonetheless considered whether the inclusion of such a note would have altered Sherman's conduct. He found that it would not have done so.

63 The trial judge found that even if a going concern note had been included in the financial statements of Gatsby and Elegance, Sherman either would not have noticed it, or if he did notice it, he would not have stopped making interest payments earlier than he did. In essence, the trial judge held that once Sherman had made his investments, he paid virtually no attention to them. In paras. 97 and 98 of his reasons, the trial judge sets out his important findings on causation:

Nor would I find that Dr. Sherman would have decided to cease payments of interest if the financial statements for 1987 had contained such a note drawing the unit holder's attention to delays in obtaining financing, and in the acquisition of yachts, and the effect that this might have on the operation of the businesses for which the limited partnerships had purportedly been established. I am not satisfied that he would have noticed a going concern note or, if he had done so, that he would have taken any action. The absence of any evidence of his discussions with his professional advisers is consistent with my general impression that, once the investments were made, he paid little, if any, attention to them. His inaction and passivity continued after he had received the initial letter of August 25, 1987 from Revenue Canada while other investors were voicing their concerns at the annual meetings of the limited partnerships. It was not until November 1988, when he asked Mr. Florence to attend the meeting to be held on December 6, that he first showed any interest in the tax issues that threatened to destroy the value of his investment. Even then there was no evidence of any report received from Mr. Florence or, indeed, that he had attended the meeting.

Given the lack of any evidence of information or advice received from his professional advisers, the suggestion that they were paying attention for him was not persuasive. It was more probable, I believe, that he had too many business concerns and other responsibilities to enable, or motivate, him to attend to his investments in the limited partnerships. The burden of proving that any loss he suffered by continuing to pay interest after April 1988 was caused by the accountants' failure to place a going-concern note in the financial statements for 1987 is on Dr. Sherman. On a balance of probabilities, I am not satisfied that he, or his advisers, would have read such a note or that, if he had done so, it would

have affected his decision. In the circumstances, I would find that the burden of proving causation was not discharged. [emphasis added].

64 These findings are, of course, findings of fact, protected in this court by a highly deferential standard of review. In order to overturn them, Sherman must demonstrate that these findings are tainted by palpable and overriding error.

65 Sherman submits that he can meet this stringent standard of review. He contends that these findings reflect palpable and overriding error because they conflict with evidence the trial judge had already accepted: the evidence that Sherman stopped making payments in 1990 after hearing rumours of fraud and consulting with his professional advisers. At para. 19 of his reasons, during his review of the narrative, the trial judge observed:

At the end of 1988, Dr. Sherman continued his practice of sending post-dated cheques for interest payable each month in the coming year. He did not comply with the request for cheques for 1990. He testified that he had heard rumours that suggested the possibility of fraud and, after consulting Mr. Florence and his tax counsel, David Nathanson, he decided not to make further payments.

66 Sherman argues that this paragraph conflicts with the trial judge's later findings on causation, and that therefore those findings cannot stand. He says that either he or his advisers would likely have reviewed the financial statements of Gatsby and Elegance. And, his later action in stopping payments shows that it was inconceivable he would have ignored a going concern note if one had been included.

67 If the trial judge's findings of fact on causation were not rooted in the evidence - in other words, if there was no evidence to support them - then they would amount to palpable and overriding errors. But that is not the case. I see nothing inconsistent between the trial judge's observation at para. 19 of his reasons, and his later findings on causation. More importantly, there was a good deal of evidence to support these causation findings.

68 The main evidence supporting the finding that Sherman would not have noticed a going concern note came from him. He testified that he did not recall reviewing the financial statements of Gatsby and Elegance. Indeed, he gave evidence that he could not even recall whether he requested these statements or received them. Although Sherman also gave evidence that his advisers would likely have reviewed the financial statements on his behalf, not one of his advisers testified at trial.

69 More broadly, I think the record also shows that in deciding to invest and to continue to make interest payments, Sherman relied not on the advice of the respondents or on the financial statements prepared by them, but on the assurances given by OCGC and its sole shareholder, Bellfield.

70 Sherman at first refused to close the transaction because he had not received documents and

assurances that satisfied him. Eventually, on April 29, 1986, Sherman, OCGC, and Bellfield entered into a settlement agreement. Under that agreement, OCGC and Bellfield guaranteed Sherman's income tax deductions and write-offs, and agreed that he could set off any deficiency against his monthly interest payments. With these assurances and security, Sherman closed his investment transactions.

71 Sherman admitted at trial that he required the April 1986 agreement to satisfy himself that the business was legitimate. From the outset, he was aware that Revenue Canada might disallow his tax deductions and write-offs. However, having sought and obtained guarantees from OCGC and Bellfield, he was comfortable with the risk. By contrast, during the entire period, he never once sought the respondents' advice on his investments.

72 Sherman had the burden to show that on a balance of probabilities he would have acted on a going concern note, if the respondents had included one in the financial statements of Gatsby and Elegance. The evidence that I have reviewed supports the trial judge's finding of fact that even if the respondents had included such a note, Sherman would not have noticed it.

73 The trial judge's finding - which I would uphold - that Sherman would not have noticed a going concern note disposes of the causation issue. However, the record amply supports the trial judge's alternative causation finding: even if Sherman had noticed a going concern note, he would not have acted differently.

74 Admittedly, by 1990 Sherman did stop making interest payments. The trial judge, however, had a lot of evidence to indicate that even a going concern note would not have prompted Sherman to stop payments earlier. That evidence consists of the numerous pieces of information bringing into question the viability and legitimacy of Sherman's investments - information that Sherman knew about, yet ignored, all the while continuing to make his monthly interest payments.

75 For example, as early as 1986, Sherman knew that the Gatsby yacht would have to be replaced or rebuilt because of problems with the shipyard. By late 1988, Sherman was aware of the concerns expressed by purchasers of units of other limited partnerships at the annual meeting of investors held in August. In late November 1988, Sherman received a letter from OCGC advising him and the other investors of the uncertain status of their investments and of their tax write-offs. As early as January 1989, his professional advisers told Sherman that his tax write-offs might be disallowed.

76 Most telling of all, in June 1989, Sherman received a letter from Revenue Canada advising him that OCGC had failed to demonstrate Gatsby was properly constituted and carrying on business, and that OCGC's loans appeared to have no substance and did not appear to have been made with any intent to earn income. Revenue Canada's letter was at least as dire a warning about OCGC's viability as a going concern note would have been. Yet, in the face of this letter, Sherman made no enquiries about the status of the two yachts, and he continued to make monthly interest payments for another six months. In the light of this evidence, the trial judge can hardly be said to have been palpably wrong in concluding that Sherman would not have taken any action on a going

concern note.

77 I make one concluding observation. This was a thirteen-day trial. The trial judge lived through this trial and, unlike this court, heard all the evidence as it unfolded. He had the opportunity, unavailable to us, to observe the appellant testify over two days. He was left with the impression of a man with too many businesses and other responsibilities and interests to pay much attention to his investments once he had made them. Much of the evidence confirming this impression came from Sherman himself. This court would not be justified in interfering with the trial judge's assessment of Sherman and of his likely inaction even if the respondents had done what the appellant claims they should have done. Cases such as this one demonstrate the wisdom of a highly deferential standard of appellate review. I would dismiss the appeal.

D. CONCLUSION

78 The trial judge did not apply the wrong standard of care for a review engagement. Nor did he err in concluding that the respondents were not negligent in failing to include a going concern note in the financial statements of Gatsby and Elegance. Moreover, even if the respondents had included a going concern note, the trial judge did not commit a palpable and overriding error in finding either that Sherman would not have noticed such a note, or that if he did notice it, he would not have acted on it.

79 The appeal is dismissed with costs to the respondents on a partial indemnity basis. Counsel advised the court that they likely could agree on the amount of costs. If they are unable to do so, they may make written submission to the court within thirty days of the release of these reasons. Finally, I thank both counsel for a well-argued appeal.

J.I. LASKIN J.A.

E.A. CRONK J.A. -- I agree.

E.E. GILLESE J.A. -- I agree.

cp/e/qw/qlnxd/qlgxc

e/drs/qljzb/qljal

¹ The Handbook was amended effective January 1, 1989, and some of the procedures for performing review engagements were modified. But the basic principles remained the same.