Case Name:

Sherman v. Orenstein & Partners

Between
Dr. Bernard Sherman, plaintiff, and
Orenstein & Partners, Peter Browning and Albert Title, defendants

[2003] O.J. No. 3361

[2003] O.T.C. 787

125 A.C.W.S. (3d) 162

File No. 96-CU-116411

Ontario Superior Court of Justice

Cullity J.

Heard: January 27, April 28-30, May 1-2, 5, 7-8, 13-14, 29 and June 5, 2003.
Judgment: September 3, 2003.

(114 paras.)

[Editor's note: Additional reasons for judgment were released March 1, 2004. See [2004] O.J. No. 782.]

Professional occupations -- Accountants -- Negligence -- Duty of care -- Standard of care -- Reviews, non-audit -- Duty to third parties.

Action by Sherman against an accounting firm for damages for negligence and negligent misrepresentations in the preparation of financial statements. Sherman was the only limited partner in two of 79 limited partnerships promoted by Bellfield for the purpose of acquiring and chartering luxury yachts in the Mediterranean and Caribbean. 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. Ultimately, all of the 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 for tax purposes in that they were never intended to operate the businesses for which they were purportedly established. However, there was no evidence that the firm had actual knowledge that Bellfield was dishonest and had made fraudulent misrepresentations. Rather, Sherman alleged that the firm had information which should have caused it sufficient concern that it should have given a warning to limited partners, through a going concern note. When Sherman made his investments, neither of the partnerships had commenced to carry on a business. The firm made inquiries, and accepted management's explanation for this. Expert evidence indicated that the degree of investigation and verification required before an accountant would feel justified in attaching a going-concern note would ordinarily not have been considered to be compatible with the standards applicable to a review engagement.

HELD: Action dismissed. Sherman had not proved that the firm did not meet the standard of care required of it. 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. The court could not substitute its judgment for the firm's. The fact that Sherman had been defrauded by Bellfield was irrelevant. Sherman had to prove negligence in the performance of the firm's professional responsibilities and not merely an exercise of judgment with which reasonable accountants might disagree. The degree to which reasonable accountants might differ concerning the accounting principles applicable to review engagements was significant. Despite Sherman's attempts to find warning signals in the information acquired by the firm, without the benefit of hindsight, the signals were not as clear as Sherman suggested. In addition, Sherman was not oblivious to the risks attaching to his investment, and was not a naive or uninformed investor.

Statutes, Regulations and Rules Cited:

Limited Partnerships Act, R.S.O. 1990, c. L.16, s. 13.

Ontario Rules of Civil Procedure, Rules 8.01(1), 53.07, 53.07(2), 53.07(2)(a), 53.07(4)(a).

Partnerships Act R.S.O. 1990, c. P.5, s. 11.

Counsel:

D.H. Jack, Lauren Fishman and David C. Nathanson, for the plaintiff.
Nina Perfetto, T. **Takishita** and Peter Harris, for the defendants.

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1 **CULLITY J.**:-- The plaintiff seeks damages for the alleged negligence, and negligent

misrepresentations, of the defendants in connection with the preparation of financial statements for limited partnerships of which he was the only limited partner. The defendants are a firm of chartered accountants and two of its partners.

2 In view of the authorities that establish that a partnership can sue, or be sued, in the firm name or in the names of all of the partners - but not in both - the manner in which the action was constituted is, I believe, irregular. Although a partnership is not a legal entity, section 11 of the Partnerships Act R.S.O. 1990, c. P.5 makes the firm liable for any wrongful act or omission of a partner acting in the ordinary course of business of the firm. Rule 8.01(1) permits actions against two or more persons as partners to be commenced naming the firm as a defendant. As it was not suggested that Messrs. Browning and Title were acting otherwise than in the ordinary course of the firm's business and as, in the case of a general partnership, all of the partners will be jointly liable on judgments against the firm, the addition of the two partners as defendants serves no purpose and is irregular: see the discussion by Borins J.A. in Kucor Construction and Developments & Associates v. The Canada Life Assurance Company et al. (1998), 41 O.R. (3d) 577 (C.A.), at pages 587-9.

3 The liability of the firm is said to arise from the manner in which Messrs. Browning and Title performed the responsibilities of the firm as the accountants for two limited partnerships known as "Great Gatsby" and "Elegance". These were registered under the Limited Partnerships Act R.S.O. 1990, c. L.16 and the plaintiff purchased all of their limited partners' units, in 1985 and 1986 respectively.

1. Background

4 Great Gatsby and Elegance were two of 79 limited partnerships registered by Einar Bellfield between 1984 and 1991 - ostensibly for the purpose of acquiring, and chartering, luxury yachts in the Mediterranean and Caribbean. Thirty-six of the partnerships were fully subscribed - their limited partnership units having been acquired by approximately 600 investors. The general partner of each limited partnership was Overseas Credit and Guarantee Corporation ("OCGC") of which Bellfield was the sole shareholder.

5 The partnerships were marketed to investors in Canada as tax shelters and, for the plaintiff, this was certainly their primary - and, probably, their only - attraction. In 1987 Revenue Canada commenced an audit and investigation into their activities and, in a letter of June 15, 1989, the plaintiff was informed that the partnership's tax losses, and interest deductions he had claimed in 1985, 1986 and 1987 in respect of his investment in Great Gatsby, would be disallowed. In the letter, Revenue Canada stated that the general partner of Great Gatsby had failed to demonstrate that the partnership was properly constituted and carrying on a business. It was stated, further, that interest on the loans purportedly made to enable the plaintiff to purchase units would be disallowed on the ground that the loans appeared to have no substance and, in any event, were not laid out to earn income. On July 21, 1989 the plaintiff was advised that his tax return for 1988 - in which he had claimed business losses of $ 1,449,548 in respect of his investment in the two limited partnerships - would be held in abeyance pending completion of the department's review of them.

6 Ultimately, all of the losses and deductions claimed by the plaintiff in connection with the limited partnerships were disallowed and tax was assessed on that basis. Notices of objection were filed but minutes of settlement with the Crown were signed on June 13, 1996 in which the assessments were confirmed with a waiver of penalties and interest.

7 At the trial of this action it was not disputed that the limited partnerships promoted by Bellfield were part of a scheme in which he obtained funds from investors by way of fraudulent misrepresentations. No yachts were ever chartered and the very few that were acquired may have been intended only to give an appearance of legitimacy to the scheme. The success of the chartering businesses in which the limited partnerships were purportedly to be involved was entirely dependent on OCGC's ability to finance the construction of the yachts. Financing was never obtained. OCGC's sole source of funds appears to have been the amounts obtained from the investors which, although substantial, were not adequate for the purpose and were very likely appropriated by Bellfield.

8 On November 16, 1999, Bellfield was indicted on charges of defrauding the Crown of the tax payable in respect of losses of $ 118 million claimed on behalf of the 36 limited partnerships, and of defrauding their unit holders. He was convicted and sentenced to 10 years' imprisonment and a fine of $1 million.

9 Neither the existence of Bellfield's fraudulent intentions nor the complex manner - involving OCGC and number of offshore corporations - in which he attempted to implement them were directly in issue in this action. It was accepted that the limited partnerships were shams for tax purposes in that that they were never intended to operate the businesses for which they were purportedly established. It followed that if, as occurred, Revenue Canada was successful in penetrating a maze of apparently sophisticated, but largely fictitious, transactions and documentation, the plaintiff would not obtain the tax benefits that had led to his acquisition of units. However, the central issue in this action is not whether the defendants should have discovered, or suspected, that the limited partnerships were part of a fraudulent scheme. The damages claimed by the plaintiff relate only to interest payable in the period after April 1988 - when the accountants had completed their work on the financial statements of the limited partnerships for their fiscal years ending December 31, 1987 - and before January 1990 when the plaintiff declined to make further payments. The thrust of Mr. Jack's submissions was that, by May 1988, the defendants had acquired sufficient information, that was not available to the plaintiff at the time he purchased his units, to require them to advise him that there was a material risk that the business and fiscal purposes for which the limited partnerships were purportedly established would not be achieved. It was implicit in these submissions that it was unnecessary to establish that the information from which the risk should have been identified also gave rise to an inference of fraud on the part of the promoter. There was no suggestion that any such inference should have been drawn by the defendants in the period in question, or that they were in any way implicated, or complicit in, the fraud.

2. The Facts

(a) Evidence of the plaintiff

10 The plaintiff is a professional engineer with science degrees from the University of Toronto and The Massachusetts Institute of Technology. He is at present the chair of a large public company. He testified that the possibility of investing in the limited partnerships was brought to his attention by a neighbour who is a lawyer. He was first shown documentation relating to another limited partnership and, later, he probably saw the offering memorandum for Great Gatsby. He was told that it had acquired a yacht that needed refurbishing. He referred his informant to Michael Florence C.A. who he described as his external adviser on investments and tax issues. On receiving a positive report from Mr. Florence, he decided to purchase all of the units of Great Gatsby. He understood that the funds to be applied to the purchase of the units would be advanced by way of a loan to him by OCGC.

11 The plaintiff retained a lawyer in connection with his subscription for the units of Great Gatsby and the related loan transaction with OCGC in December, 1985. The lawyer evidently was not satisfied with the documentation relating to Great Gatsby's ownership of the yacht. A dispute arose and correspondence and documentation relating to a settlement of this continued through April 1986. This culminated with an agreement by OCGC and Bellfield to guarantee the tax benefits that the acquisition of the units was intended to achieve.

12 From January 1, 1986 to December 31, 1989 Dr. Sherman paid $ 12,999.84 each month as interest on the OCGC loan in respect of Great Gatsby.

13 In 1986, the plaintiff purchased all of the limited partnership units of Elegance on similar terms except that no yacht had been acquired by, or on behalf of, that partnership. His interest payments from 1st January, 1987 to 31st December, 1989 in respect of the OCGC loan for this purpose were $18,750 a-month.

14 Dr. Sherman testified that he understood that the defendant firm would be the accountants for his limited partnerships and would provide financial statements. He had no clear recollection of reading the statements although he said he would have regarded them as crucial for the purpose of keeping him informed of the status of his investments. He stated that at no time did he receive information from the defendants that the investments might be at risk and the first time he heard that there could be a problem was when he started receiving letters from Revenue Canada about the delay in processing his income tax returns. Although he testified that the tax savings were not the only reason for his decision to acquire the units of the partnerships he conceded that, without the initial tax write-offs, they would probably have made no sense as investments.

15 As the correspondence relating to the settlement of the dispute with OCGC and Bellfield in April 1986 indicates, it is quite clear that Dr. Sherman knew that there was a risk that the tax benefits might be disallowed by Revenue Canada. However, he testified that these doubts related to the success of the chartering business and that he did not suspect a sham until January 1990. He stated that, even when he received letters from Revenue Canada in 1987 and 1988 informing him that a tax audit was being conducted, he was not concerned. He said he had probably expected that the partnerships would be audited as he did not regard this as unusual.

16 Again, on receipt of the letter from Revenue Canada of June 15, 1989 that contained the department's conclusions with respect to the status of Great Gatsby and Elegance and stated its intention to disallow the tax benefits he had claimed, Dr. Sherman's evidence was that it did not occur to him that there may have been a fraud. He said that he passed the letter on to his accountant and to tax counsel. Dr. Sherman insisted that his decision to continue making payments after receipt of that letter was based on his practice of honouring contractual obligations. There is no indication that he, or any of his advisers, made any inquiries of OCGC or Bellfield or raised with either of them the existence of their obligations under the guarantees provided in April, 1986.

17 In the course of his cross-examination, Dr. Sherman was shown a note in his handwriting in the following terms:

> "Mike F
>
> I am still making payments on these.
>
> > I understood others have stopped. If the boats don't exist why are we paying still?
> >
> > Should we stop?
> >
> > Barry"

18 The note appears to have been written on a calendar pad. It contains, at the top, calendar dates for the months of January, February and March, 1989. Dr. Sherman testified that it could not have been written in those months as they were before he had received the letter from Revenue Canada notifying him of its intention to disallow the tax benefits. He stated that the note was probably written towards the end of the year or early in 1990.

19 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.

20 Although the tenor of Dr. Sherman's evidence was that he did not become seriously concerned about the viability of his investment until the end of 1989, I am satisfied that he had received information about the concerns of unit holders of other limited partnerships expressed at their annual meetings in August 1988. This information was contained in letters from OCGC to the investors. In a letter of September 7, 1988, the investors were informed that Arthur R.A. Scace - an experienced tax counsel - had been recently retained to discuss the tax issues raised by Revenue Canada and, in particular, the department's questions with respect to the financing mechanisms put in place by OCGC.

21 Dr. Sherman did not attend the annual meetings or any other meetings of the investors at which the tax problems were discussed. He requested Mr. Florence to attend a meeting to be held on December 6, 1988 at which Mr. Scace was to be available to answer the investors' questions but he could not recollect what, if any, information or advice he received from Florence after the meeting.

22 In general terms, Dr. Sherman's evidence was that, as a very busy person at the head of an enormous organization, he relied heavily on his personal advisers and had no reason to stop making interest payments until he heard rumours of fraud towards the end of 1989. There was virtually no evidence of the extent to which his advisers investigated the problems with Revenue Canada, any information they obtained or of the advice they provided to him. He was frank in admitting his inability to recall whether he had seen and reviewed various documents but adamant that he did not regard the fact that Revenue Canada was conducting a tax audit as a cause for serious concern. He made no inquiries of the defendants and did not recollect that he had ever spoken with Mr. Title or Mr. Browning.

23 There was no evidence of any other investments made in the period by Dr. Sherman for tax sheltering purposes or otherwise. However, it is remarkable that, even after the disallowance of the losses and deductions claimed in respect of Great Gatsby and Elegance for his taxation years 1985 through 1988, he obtained a refund of tax, and interest, in excess of $ 2.5 million. Dr. Sherman was unable to explain this. The overall impression I obtained from his testimony was of an individual whose position and extensive responsibilities as chair of a large public corporation compelled him to neglect his personal financial and investment interests except to the extent that he referred and, delegated, particular matters to his professional advisers. However, there was no evidence that he provided them with the annual financial statements of the limited partnerships, or that he had reviewed them in any detail. He had no specific recollection of receiving and reading them. At the most, he could only assure the court that he believed he would have read the parts that interested him when he found them in the large stack of mail that was placed on his desk every day. The evidence does not satisfy me that he would have done anything more than glance at them in a perfunctory fashion.

(b) Evidence of the defendants

24 Mr. Title was called, and gave evidence, on behalf of the defendants. On May 2, 2003, I gave Mr. Jack leave to call Mr. Browning pursuant to rule 53.07.

25 At the commencement of the trial on January 27, 2003 there was some discussion of the question whether Ms. Perfetto intended to call Mr. Browning as a witness. No definite answer was provided by Ms. Perfetto on that occasion. On May 2, 2003, in the course of the trial, Mr. Jack informed me that he had been advised on the previous day that Ms. Perfetto did not intend to call Mr. Browning. On May 2, Mr. Jack provided Ms. Perfetto with a notice of his intention to call Mr. Browning pursuant to rule 53.07(2) and he moved for leave to do so notwithstanding the failure to serve the notice at least 10 days before the commencement of the trial in accordance with rule 53.07(2)(a).

26 In granting Mr. Jack's request for leave, I decided that it was necessary in the interests of justice to abridge the time for the notice required by rule 53.07(2)(a). I do not know what, if any, communications took place between counsel before January 27 but they are highly professional and experienced and it must, I believe, have been clear to Ms. Perfetto that Mr. Jack would be likely to wish to call Mr. Browning if she did not intend to do so. He advised the court that he was surprised by her ultimate decision and my understanding of his position on January 27 had been that he would apply for leave if she chose not to call Mr. Browning. It was also clear that, pursuant to rule 53.07(4)(a), Mr. Jack would be unable to do this if Ms. Perfetto intended, and gave an undertaking, to call Mr. Browning as a witness.

27 After Mr. Jack had raised the question on January 27, the matter was left in abeyance and, shortly after he had commenced his opening statement, the trial, unexpectedly, had to be adjourned for three months. In consequence, there was no suggestion by Ms. Perfetto that she was taken by surprise by Mr. Jack's response to her communication of May 1 or that her clients would suffer prejudice if the requirement of timely notice was abridged, or dispensed with. She had, in effect, been given three months anticipatory notice. I was satisfied that Mr. Browning's evidence was likely to be highly relevant to the issues raised in the statement of claim and that any failure by Mr. Jack to ascertain Ms. Perfetto's intention prior to the commencement of the trial was based on a not unreasonable - although with hindsight, perhaps, unwise - assumption that she would call Mr. Browning. In these circumstances, I granted Mr. Jack's request for leave to call Mr. Browning as a witness.

28 Orenstein & Partners was retained by OCGC in the fall of 1985 to provide a tax opinion in connection with the 1985 limited partnerships. Mr. Browning was the partner responsible for this work. However, another firm of chartered accounts provided the tax opinion that was part of the offering memorandum for Great Gatsby. An opinion of the defendants was part of the offering memorandum for Elegance that was distributed in 1986.

29 While Mr. Browning was, initially, the partner in charge of the defendants' file dealing with the limited partnerships, Mr. Title assisted him in the work of commenting on the financial statements for the 1985 limited partnerships - including Great Gatsby. In the years that followed, the responsibility was primarily that of Mr. Title. Mr. Browning - who was principally a tax specialist - continued to do work for OCGC as well as other clients. In addition to commenting on the financial statements for Great Gatsby and Elegance, Mr. Title was performing the same exercise and responsibility for 20 other limited partnerships promoted by Bellfield and managed by OCGC for essentially the same purposes.

30 Each of Browning and Title testified as to their understanding of their functions and responsibilities in conducting a review engagement prior to, and after, 1987 and the distinction between such responsibilities and those involved in performing an audit.

31 In eliciting evidence from Messrs. Brown and Title - as well as in his opening and closing submissions - Mr. Jack concentrated on information relating to the viability of the businesses for which the limited partnerships were created that either, or each, of the accountants had acquired by the end of April, 1988. In his submission, this information considered in its entirety - and irrespective of the extent to which it had been shared between them - cast sufficient doubt on the ability of the partnerships to achieve their business and investment objectives as to require the insertion in the financial statements for 1987 of a going-concern note referring to such doubt. Mr. Jack's submissions were supported by the expert opinion of accounting standards provided by Mr. Irving Rosen - a chartered accountant, and a partner, of the firm of Soberman, Isenbaum & Colomby LLP.

32 In Ms. Perfetto's submission - supported by the evidence of Messrs. Browning and Title and the expert evidence of Dr. Laurence Rosen - a going-concern note was not required under the applicable accounting standards.

33 Ms. Perfetto did not take issue with Mr. Jack's submission that any information obtained by Mr. Browning when acting for OCGC was information of the firm to which all partners - including Mr. Title - had access. Nor was there any substantial dispute with respect to the extent of the information obtained by Mr. Browning. The difference between the positions of the parties relate, for the main part, to the significance of particular information and to the application of the professional standards established by the Canadian Institute of Chartered Accountants for review engagements of the kind performed by the defendants for the limited partnerships' financial years ending 1985 (Great Gatsby only), 1986 and 1987.

34 The information acquired by Mr. Browning to which Mr. Jack asked me to attribute significance related, in the main part, to:

(a) a revision of the unaudited financial statements of OCGC for 1986 that replaced net earnings of $ 23 million with a loss of $ 11.7 million;
(b) a reference in a tax memorandum prepared by one of Mr. Browning's colleagues to the unlikelihood that interest on indebtedness owing to OCGC would ever be paid;
(c) a draft response to questions raised by Revenue Canada that referred to difficulties OCGC was experiencing in obtaining financing for the limited partnerships;

(d) a note placed on OCGC's audited financial statements for 1987 referring to the auditors' inability to verify a transfer of notes in excess of $205 million to a related corporation;

(e) notes made by Messrs. Browning and Title during the preparation of the limited partnerships' financial statements for 1987 that indicate that they had discussed whether a going-concern note should be added; and

(f) disclosure in an offering memorandum for a proposed limited partnership to invest in real property and mortgages that OCGC would incur significant contingent liabilities.

35 I will defer consideration of the evidence of Mr. Browning and Mr. Title with respect to the significance of this information until later in these reasons. At this stage, I note that I am not satisfied that the information in categories (a), (d) and (f) came to the attention of Mr. Browning prior to May, 1988. The auditor's report on the financial statements of OCGC for 1987 that contained the revision of the corporation's statements for 1986, and the note referring to the transfer of funds to a related corporation, was dated 7th November, 1988 and the evidence does not, in my opinion, justify a finding that it was brought to the attention of Mr. Browning before May, 1988, if at all. Similarly, although Mr. Browning testified that he would have been working on the offering memorandum for the realty fund before August 16, 1988 - the date on the offering memorandum - I am not prepared to find that the existence of OCGC's intention to guarantee payment of certain amounts was communicated to Mr. Browning earlier than May of that year.

36 In addition to Mr. Browning's evidence with respect to the above matters, Mr. Jack relied on evidence of Mr. Title that, before 1987, he was probably aware that the corporation originally engaged to refurbish and construct the yachts - a corporation in which Mr. Bellfield had an interest - had been placed in bankruptcy; that the yacht originally acquired for Great Gatsby was not in satisfactory condition and would have to be refurbished or replaced; that Great Gatsby - which had initially been projected to produce revenues of $ 985,500 in 1987 - had no revenues in that year; and that Revenue Canada's tax avoidance section was conducting a tax audit of OCGC's limited partnerships and their unit holders.

(c) Evidence of accounting standards.

37 The defendants were retained to perform a review engagement - and not an audit - of the financial statements of Great Gatsby and Elegance in each of the years in which Dr. Sherman made interest payments. The standards contained in the CICA Handbook for such reviews were changed effective January 1, 1989. The experts did not agree on the significance of the changes and this, I believe, had some bearing on the opinions they expressed with respect to the obligations of the defendants with respect to the financial statements for 1987 that are said to have been released on April 30, 1988. The earlier standards that applied to the performance of those obligations were described in paragraphs 13 and 14 of section 8900 of the CICA Handbook:

"In a review engagement the public accountant's objectives, and accordingly his procedures, differ substantially from those in an audit engagement. An auditor's objective is the expression of an opinion on financial statements. On the other hand, in a review engagement the public accountant's objective is the preparation for his client, of financial statements that are plausible in the circumstances (or the review of client-prepared financial statements to consider whether they are plausible in the circumstances). In this section, the word "plausible" is used in the sense of appearing to be worthy of belief based on the information obtained by the public accountant in connection with his review; however, it does not rule out the possibility of undetected fraud or error.

"The public accountant assumes no responsibility for the expression of an opinion on the unaudited financial statements; the fairness of the representations made through the financial statements remains the client's responsibility. The public accountant's limited objective can be achieved with a less detailed knowledge of the business and a less penetrating study of its affairs than is required in an audit."

38 Paragraph 8900.19 of the Handbook stated:

"A review should be designed to meet the limited objective of considering whether the information provided to the public accountant relative to the financial statements and the statements themselves are plausible in the circumstances. It should be founded on a general knowledge of the business and should consist primarily of:

a) enquiries concerning financial, operating, contractual and other information, and consideration of information received in response thereto;
b) comparison of the current and prior period financial information and consideration of the reasonableness of financial and other inter-relationships; and
c) discussions with responsible client officials concerning information received and the financial statements."

39 In accordance with the Handbook, the financial statements of Great Gatsby and Elegance for their 1987 financial years contained the following:

"Accountants Comments

We have prepared the accompanying balance sheet as at December 31, 1987 and

> the statements of income and partners' capital for the period from January 2, 1987 to December 31, 1987 from the records of [the partnership] and from other information supplied to us by the partnership. In order to prepare these financial statements we made a review, consisting primarily of an enquiry, comparison and discussion, of such information. However, in accordance with the terms of our engagement, we have not performed an audit and consequently do not express an opinion on these financial statements."

40 The experts were in agreement that the standards that governed the review engagement conducted with respect to the 1987 financial statements were significantly lower than those that would have been applicable to an audit. Whereas an auditor would be required to look for verification and corroboration of the figures and other information presented, and to express an opinion on their fairness as a representation of the financial state of the entity, the emphasis in a review engagement was merely on the plausibility of the information provided.

41 As modified after January 1, 1989, plausibility, as defined previously in section 8900 of the Handbook, continued to be a criterion to be applied. In addition, the procedures to be followed in conducting a review were broadened by the provisions of paragraph 8100.19 which replaced those previously in paragraph 8900.19:

> "8100.19. A review consists primarily of:
>
> (a) making enquiries concerning financial, operating, contractual and other information, and considering responses that, in addition to oral responses, may take the form of listings, schedules or other documents;
>
> (b) applying analytical procedures such as comparing the current and prior period information and considering the reasonableness of financial and other inter-relationships. Analytical procedures performed during a review engagement would normally be less extensive than analytical procedures performed during an audit. Explanations for relationships and individual items that appear to be unusual would be obtained by directing enquiries to appropriate personnel of the enterprise, the responses to which the public accountant is entitled to accept without examination of supporting evidence as long as such responses appear plausible;
>
> (c) having discussions with appropriate officials of the enterprise concerning information received and the information being reported on."

42 A further change that had, I believe, more than formal significance was that the standard form for review engagements replaced that containing the "Accountants Comments" with the following:

"Review Engagement Report

To:

I have reviewed the balance sheet of ... as at .... and the statement of income, retained earnings and changes in financial position for the year then ended. My review was made in accordance with generally accepted standards for review engagements and accordingly consisted primarily of enquiry, analytical procedures and discussion related to information supplied me by the company.

A review does not constitute an audit and consequently I do not express an audit opinion on these financial statements.

Based on my review, nothing has come to my attention that causes me to believe that these financial statements are not, in all material respects, in accordance with generally accepted accounting principles.

(signed)............

Chartered Accountant" (italics added)

43 While the experts were in agreement with respect to the general nature of the changes introduced into the Handbook for engagement reviews after January 1, 1989, they differed with respect to their extent and their significance. The issues that arise from these conflicting opinions can I think most usefully be deferred until later in these reasons but, in general terms, I believe it is fair to say that the defendants' expert, Dr. Laurence Rosen, attributed more significance to the changes in the standards than the plaintiff's expert, Mr. Irving Rosen was prepared to concede. Apart from an addition of a requirement of objectivity to which I will refer below, I understood Mr. Irving Rosen's view to be that the changes were more formal than substantive. Dr. Laurence Rosen was of the opinion that, before January 1, 1989, the standards were less stringent and less well-defined. It was, I believe, clear that Mr. Irving Rosen believed that before, as well as after, that date accountants performing a review engagement were required to consider representations made by management with a degree of scepticism that Dr. Laurence Rosen did not believe would be appropriate. This disagreement affected the situations in which each believed there would be an obligation to seek verification by, at least, making further inquiries of management. In Dr. Laurence Rosen's view, the accountant was generally entitled to accept at face value representations and information provided by management unless it appeared to be inconsistent with other information that the accountant had obtained. A review engagement was not intended to detect plausible representations made by a plausible rogue, or anyone else.

44 While these divergent views reflected differences of degree - each would require something to "trigger" a further inquiry and they disagreed on what would be sufficient - the differences could not be described in terms of subtle nuances. Mr. Irving Rosen, for example, considered an inquiry into the plausibility of financial statements to require an accountant to determine whether they were reasonable in the circumstances. He saw no difference between an inquiry expressed in such terms and a question whether the financial statements appeared "to be worthy of belief based on the information obtained by the public accountant in connection with his review". Dr. Laurence Rosen, on the other hand, stated that, while errors and inaccuracies were supposed to be disclosed and exposed on an audit, this would only occur on a review engagement if the accountant "stumbled" on them - if they "hit him in the head".

45 One specific point on which there was a material difference in the opinions of the experts related to the use of going-concern notes. Mr. Irving Rosen started from the proposition that, under GAAP, financial statements are prepared on:

> "the assumption that the entity is a going concern, meaning it will continue in operation for the foreseeable future and be able to realize assets and discharge liabilities in the normal course of operations". (CICA Handbook, para. 1000.47)

46 It followed that, in a review engagement as well as an audit, the question whether the entity was a going concern in this sense was relevant and could not be ignored. The criterion was still plausibility in the case of a review engagement and the nature and extent of the enquiries to be made if the question was "triggered" would generally be more limited than in an audit. However, if the accountant concluded that the test of a going-concern was not satisfied, there would be an obligation to add a note in the financial statements to that effect. In Mr. Irving Rosen's opinion, the defendants were obligated to attach a going concern note to the financial statements of each limited partnership for its 1987 year.

47 To say that Dr. Laurence Rosen seemed aghast at the views expressed by Mr. Irving Rosen would be an understatement. A decision to insert a going-concern note was, in his opinion, so serious that the accountant would necessarily have to conduct an inquiry and investigation that was quite incompatible with the concept of a review engagement. Dr. Rosen referred to the absence of any reference to the going-concern issue in the CICA Handbook in connection with such engagements. He described the treatment of even an auditor's obligations with respect to going concern questions as "very foggy" until 1990 when the question was clarified. Similar clarification for auditors had been found desirable in the United States where it has been said that, before financial periods commencing on, or after, January 1, 1989, the applicable statement on auditing standards of the American Institute of Certified Public Accountants read "as if an auditor must stumble over a going concern problem before recognizing its existence": Practitioner's Guide to

GASS 99, Guy and Carmichael, at 341.2.

48 I understand that it was not until 1995 that the CICA handbook was amended to insert in the guidelines for review engagements a question whether the accountant had become aware of conditions that cast doubt on the ability of the entity to continue as a going concern.

49 Dr. Laurence Rosen was not only critical of Mr. Irving Rosen's introduction of going-concern issues into review engagements but, also, of his opinion that the information possessed by the defendants would have required a going-concern note if such issues had been relevant. In these particular respects, as well as generally, he was strongly of the opinion that the views of his eminent colleague would "escalate" review engagements into audits.

50 Before leaving this summary review of the expert evidence, there are two other aspects I should mention. The first is that Mr. Irving Rosen was heavily critical of the contents of the files produced by the accountants. As it appears that the original files were taken by - and not retrieved from - Revenue Canada and that the documentation produced at the trial was incomplete, I do not think I would be justified in attaching significant weight to this criticism.

51 The remaining matter concerns certain comments made by Mr. Irving Rosen with respect to alleged conflicts of interest that, in his opinion, materially affected the obligations of the defendants. A related question concerns the introduction of standards of objectivity for review engagements in the amendments to the relevant sections of the CICA Handbook as of January 1, 1989. These matters were addressed at some length by Mr. Irving Rosen in his report prepared for counsel. The report is not part of the evidence in these proceedings and the contents of the relevant passages were not covered in Mr. Rosen's evidence in chief. I understood Mr. Jack to indicate in his closing submissions that he was not relying on alleged breaches of duty arising from any conflict of interest as such and I propose to dispose of the issues on that basis.

3. The law

52 In the statement of claim - as originally issued - the plaintiff claimed damages for negligence. In an amendment made on consent at the commencement of the trial, a claim for negligent misrepresentation was added. In their closing submissions, counsel addressed the question of whether a fiduciary relationship existed between the parties. However, no separate claim for breach of a fiduciary duty was pleaded. While, in their closing submissions, counsel differed on the manner in which the governing legal principles should be applied to the facts - as well as on the findings of fact that should be made - they were in general agreement with respect to the content of the legal principles and the authorities in which they were to be found.

53 For the claim based on negligence, Mr. Jack relied heavily on the decision of the Court of Appeal in Bloor Italian Gifts Ltd. et al. v. Dixon et al. (2000), 48 O.R. (3d) 760 for the following propositions:

(a) the defendants owed a duty of care to the plaintiff; and
(b) the professional standards of conduct in the CICA Handbook with respect to review engagements provide a persuasive guide to be used in determining the standard of care applicable to the defendants.

54 Ms. Perfetto did not dispute the correctness of proposition (b) but submitted that Bloor Italian Gifts was distinguishable on the question of a duty of care and, I think, that the court should follow the decision of the Supreme Court of Canada in Hercules Management Ltd. v. Ernst & Young, [1997] 2 S.C.R. 165 on this point. In her submission, the defendants owed no duty of care to the plaintiff as he was not their client and, in any event, their conduct conformed to the standards in the Handbook. Mr. Jack's submissions were to the contrary on each of these points.

55 On the issues relating to liability for negligent misrepresentation, each counsel relied on the principles stated in Queen v. Cognos, [1993] 1 S.C.R. 87. They differed on whether any inaccurate representation had been made by the defendants and whether, in continuing to make interest payments, Dr. Sherman relied on the financial statements and on the fact that they had been reviewed by the defendants.

56 Counsel were agreed that the principles stated in Hodgkinson v. Simms, [1994] 3 S.C.R. 377, should determine whether there had been any breach of fiduciary duty. They differed principally on whether the elements of vulnerability and reliance discussed in the reasons delivered in Hodgkinson were present in this case.

57 The other authorities cited by counsel were very largely illustrations of the application, in different factual contexts, of the principles in the leading cases I have referred to.

4. Analysis.

58 It is, of course, imperative that, to the extent humanly possible, the issues in this case must be determined without the influence of hindsight. In particular, the defendants are entitled to have the nature, extent and implications of their obligations identified on the basis of the information of which they had knowledge - or reasonably ought to have had by the end of April, 1988 - and any reasonable inferences to be drawn from it.

59 The defendants did not know that Bellfield was dishonest and had made fraudulent misrepresentations or - if this is true - that he had no expectation that yachts would ever be delivered to Great Gatsby and Elegance and chartered by them. There is no evidence that the defendants had actual knowledge of any of these things and it was not suggested that, as reasonable persons - as well as qualified professionals - they should have drawn inferences of this nature. At the most, it was submitted on behalf of the plaintiff that they had information from which they ought to have inferred that there was doubt that the objectives for which the limited partnerships were ostensibly established would be achieved. It was submitted further that the doubt was sufficiently serious to require a warning to be given to limited partners, through a going concern note, or otherwise.

60 In discarding hindsight, I have been careful not to attribute to the defendants knowledge that, as of April 30, 1988, they knew that Revenue Canada would disallow the tax benefits that the limited partnerships were intended to achieve. Mr. Title had asked for, and reviewed, a letter from OCGC's tax counsel dated December 4, 1987 which reported substantial success in satisfying Revenue Canada with respect to the existence and validity of the limited partnerships and the legitimate business operations of OCGC. As late as January 31, 1989, Mr. Scace was advising that, despite "innumerable" conversations with officials of Revenue Canada - including the "Head of Tax Avoidance" - they were unprepared to communicate any details of the situation. He was prepared to state only that "I suspect that they propose to assess".

61 Mr. Jack did not, of course, submit - or need to submit - that, by May, 1988, the accountants had knowledge of Revenue Canada's intentions - or even that they reasonably should have inferred that there would be an assessment. Acceptance of his submissions would not attribute to them more than a reasonable inference that there was a serious risk that assessments would be made. Hindsight, however, must not be allowed to affect that question.

62 I believe it is also imperative to keep in mind from the outset that these investments were of an obviously speculative nature. Despite Dr. Sherman's suggestion that he was not exclusively interested in their hoped-for tax advantages, it is quite evident that they were tax-driven. To achieve their tax benefits, it was essential, in the eyes of Revenue Canada, that the business for which the limited partnerships would be established would need to have a demonstrably-reasonable expectation of profit. When Dr. Sherman made his investments, neither of the partnerships had commenced to carry on a chartering business, the yacht acquired for Great Gatsby required refurbishing and there were problems with respect to its ownership. No vessel had been acquired for Elegance and the success of the business to be carried on by each partnership in the future was going to depend entirely on the good faith, experience, business judgment, management and ability to obtain financing of OCGC - a corporation wholly-owned and controlled by a single individual, Einar Bellfield.

63 The steps taken by Dr. Sherman to protect himself with tax guarantees before closing the purchase of units in Great Gatsby - plus the fact that his own legal and accounting advisers were involved in the negotiations - indicate that he was by no means oblivious to the risks attaching to the investment. He was anything but a naive, uninformed and vulnerable investor and I found his suggestion in evidence that his only - or main - concern was the risk that the chartering business might not go well to be more than a little disingenuous if, as I believe, he intended to imply that he never believed there was a risk that the tax benefits might be denied by Revenue Canada. Dr. Sherman had received the financial statements of OCGC for its financial year ending on October 31, 1985 and, under the settlement agreement of April 1986, OCGC was obligated to forward to his accountant its financial statements for each year up to December 31, 1990. Dr. Sherman had no recollection of seeing the statements but it was clear from the settlement agreement that his advisers were concerned about the security that would be afforded by a guarantee provided by OCGC. Until its shareholder's equity amounted to $ 1 million, Bellfield, and not OCGC, was to guarantee the tax benefits that provided the motivation for Dr. Sherman's investment.

64 Finally, as a preliminary matter, I note that it is irrelevant whether OCGC, or Bellfield, breached duties owed to Dr. Sherman by withholding information. The duties owed by the defendants must be ascertained, and examined, in the context of the specific professional functions they were retained to perform.

(a) Negligent provision of services: duties to advise and inform

65 Paragraph 20 of the statement of claim contains a general allegation that the defendants breached a duty owed to the plaintiff by failing to advise him of "the fact that the partnerships were not generating and were unlikely to generate any income, and were not in fact going concerns". The alleged breach is stated to have constituted negligence and a failure to comply with "the reasonable standards of the accounting profession ... in that, by no later than April 30, 1988:

(a) a reasonably prudent accountant would have revisited the assumptions originally made as to the viability of the businesses, and would have determined that the production and operation of yachts for chartering, and the plausibility and feasibility of the business operations, were questionable and in need of a reassessment;
(b) a reasonably prudent accountant would have obtained and sought out more information of a corroborative and substantive nature concerning the purported business operations;
(c) a reasonably prudent accountant would have recognized that the businesses were not operating as going concerns and would have conveyed such information in the financial statements; and
(d) A reasonably prudent accountant involved, in preparing financial statements for two or more virtually identical businesses, would have noted an absence of yachts, an absence of construction, and a dependency on OCGC that could jeopardize the alleged objectives of the businesses, and in such circumstances would have re-examined their authenticity and the premises on which the businesses were based, and reported accordingly in the financial statements."

66 In Ms. Perfetto's submission, the plaintiff's claim in negligence for the defendants' failure to inform him that Great Gatsby and Elegance were not going concerns cannot succeed as it is premised on the existence of a duty that, in law, was owed to the limited partnership and not to its partners. The submission is similar to those that were made successfully in Hercules and in Roman Corporation Ltd. et al. v. Peat Marwick Thorne et al. (1992), 11 O.R. (3d) 248 (G.D.). It ignores the fact that the plaintiffs in such cases were shareholders of corporations and, as such, were held to be unable to enforce duties owed to the corporations by their auditors. In Hercules, it was held that the audited reports were "provided to the shareholders as a group in order to allow them to take collective (as opposed to individual) decisions" (at page 211). The rule in Foss v. Harbottle was described as a corollary to this principle. In delivering the judgment of the Supreme Court of Canada, La Forest J. stated:

> "The rule in Foss v. Harbottle provides that individual shareholders have no cause of action in law for any wrongs done to the corporation and that if an action is to be brought in respect of such losses, it must be brought either by the corporation itself (through management) or by way of a derivative action. The legal rationale behind the rule was eloquently set out by the English Court of Appeal in Prudential Assurance Co. v. Newman Industries Ltd. (No. 2), [1982] 1 All E.R. 354, at page 367, as follows:
>
> > The rule is the consequence of the fact that a corporation is a separate legal entity. Other consequences are limited liability and limited rights. The company is liable for its contracts and torts; the shareholder has no such liability. The company acquires causes of action for breaches of contract and for torts which damage the company. No cause of action vests in a shareholder. When a shareholder acquires a share he accepts the fact that the value of his investment follows the fortunes of the company and that he can only exercise his influence over the fortunes of the company by the exercise of his voting rights in general meeting ....'
>
> To these lucid comments, I would respectfully add that the rule is also sound from a policy perspective, inasmuch as it avoids the procedural hassle of a multiplicity of actions." (at pages 211-2)

67 Great Gatsby and Elegance were not corporations and had no legal personality distinct from that of their partners. Duties owed to the "partnership" were, in law, owed to the partners. No authority was cited for a distinction between limited partnerships and general partnerships in this respect. As the sole limited partner of Great Gatsby and Elegance, Dr. Sherman had the protection of the limited liability conferred by section 13 of the Limited Partnerships Act as long as he did not interfere in the control of their businesses. The section permitted him, from time to time, to "examine into the state and progress of the partnership business" and the limited partnership agreement gave him power to remove and replace OCGC as general partner if it breached the provisions of the agreement.

68 Although it follows that, as limited partnerships, Great Gatsby and Elegance had attributes of corporations to a greater extent than if they were general partnerships, I see no reason of principle why that should be considered sufficient to create, or support, the proposition that duties to exercise reasonable skill and care in the performance of their professional responsibilities were owed to the partnerships and not to the partners.

69 In my view such duties included a duty to perform their review engagements in accordance with the professional standards applicable to them. These would include an obligation to attach a going concern note to the financial statements in circumstances in which such standards would require this to be done.

70 Although Mr. Jack submitted that the defendants and the plaintiff were in a fiduciary relationship and although he relied on Hodgkinson v. Simms, the amended statement of claim does not specifically plead that the defendants were in breach of a fiduciary duty owed to Dr. Sherman. To the extent that, by virtue of their relationship, the defendants may have had fiduciary duties, neither the pleading - nor counsel's submissions - identified any respects in which the content and ambit of such duties extended beyond those of the defendants' alleged duties of care in negligence. In each case, the alleged obligations were essentially obligations to advise and inform the plaintiff that the limited partnerships were not likely to operate as going concerns.

71 In his closing submissions, Mr. Jack disclaimed any reliance on the defendants' possible conflicts of interest arising from the fact that they were retained to give tax advice to OCGC, as well as to be the accountants for the limited partnerships. In these circumstances, I do not believe it is necessary - or appropriate - to consider the question of breach of fiduciary duty separately from the cause of action in negligence, or to address the theoretical question whether identification of the defendants as fiduciaries requires their duties of care to be characterized as fiduciary duties. (The question of classification is discussed in Meagher, Gummow and Lehane in Equity Doctrines and Remedies (4th edition), paras 5 - 295 ff).

(b) Negligent provision of services: the standard of care

72 In delivering the judgment of the Court of Appeal in Bloor Italian Gifts, MacPherson J.A. stated:

> "Professional standards of conduct such as those prescribed in the CICA Handbook provide a persuasive guide as to what constitutes the standard of reasonable care for a professional: see Neuzen v. Korn, [1995] 3 S.C.R. 674 at pp. 696-98." (at page 769)

73 The experts disagreed with respect to the implications of - and the consequences of applying - the professional standards applicable to review engagements. Overall, I am not satisfied that the standards in the CICA Handbook were intended to be as stringent as Mr. Irving Rosen suggested. The concept of plausibility did, I believe, permit reliance on information provided by, and representations made on behalf of, the management of OCGC to an extent that Mr. Rosen was not prepared to accept. Even under the revised sections of the Handbook applicable after January 1, 1989 it was recognized that the analytical procedures to be applied would be satisfied by such representations without examination of supporting evidence "as long as such responses appear plausible". 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.

74 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.

75 I found Dr. Laurence Rosen's approach to the going-concern question - as well as to the general standards applicable to review engagements - to be the more practical and persuasive. I accept his opinion that the degree of investigation and verification required before an accountant would feel justified in attaching a going-concern note would ordinarily not have been considered to be compatible with the standards applicable to a review engagement. I accept, also, his opinion that this, together with the absence of any reference to the going-concern question in the relevant sections of the Handbook - indicates that an inquiry into the question would not have been an essential element of a review engagement. 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. Nor do I consider this to be inconsistent with what Mr. Jack described as Dr. Laurence Rosen's "stumble test". As with the interpretation and application of the standards generally, the differences between the approaches favoured by the experts on this question related mainly to their understanding of what would be sufficient to require - or "trigger" - further inquiries. However, I did not understand it to be disputed that, in the absence of some anomaly, inconsistency, unusual feature or other reason to query the plausibility of management's representations in response to such inquiries, such representations were to be accepted.

76 In Dr. Laurence Rosen's opinion - whether the items of information acquired by Messrs. Browning and Title before May 1988 - were to be considered separately or cumulatively - they did not cast doubts or raise questions sufficient to require further inquiries by Mr. Title. In preferring his opinions to those of Mr. Irving Rosen, I believe it is important that the limited partnerships were still in their early stages by May 1988. Elegance was not projected to earn income until 1990 and, although the original projections for Great Gatsby had contemplated its receipt of revenues in 1987, Title was aware of - and had no reason to question - management's explanation for the delay: namely, that problems had been experienced with the original shipbuilder and that the yacht that had been acquired was not yet suitably refurbished. Title had quite properly asked the question and, in my judgment, his acceptance of the answers he received was in accordance with generally accepted accounting principles relating to review engagements.

77 The delay in commencing to earn revenues was explained and, by itself, it did not raise significant questions about the ability of the limited partnerships to operate in the foreseeable future as originally intended while they continued to be in the start-up phase, or thereafter. Dr. Laurence Rosen was, I believe correct, in insisting that the going-concern issue relates to the foreseeable future and that it would be a mistake to conclude that the limited partnerships could not be operating as going concerns until they commenced to earn revenues from chartering yachts. In particular, there was no reason for inferring that, during that period, they would be unable to satisfy their debts and discharge their liabilities as they fell due.

78 On hearing that problems had been encountered with the original shipbuilder, Mr. Title had made inquiries and been informed that a substitute had been found. He was provided with a copy of a letter to unit holders from OCGC informing them of this. It was obvious that there would be a delay but, by itself, this was, I believe, quite insufficient to justify - let alone require - a going-concern note to be attached to the financial statements for 1987. The fact that Title considered the question, and discussed it with Browning, is, I believe, more a reflection of his commitment to due diligence than an indication that the issue was serious or - much less - that it was wrongly decided.

79 The existence of Revenue Canada's tax audit was referred to in a note to the financial statements of each of the limited partnerships and, in my opinion, it was adequate in the light of the information available to Title - including the letter of December 4, 1987 from OCGC's tax counsel - and that which Browning had received. I do not accept Mr. Jack's suggestion that the defendant should have attributed significance to the fact that Revenue Canada's audit was being conducted by its tax avoidance section. It was a matter of public record that, in the period in question, the Ministry of Finance was concerned with the tax benefits to be obtained from the use of tax shelters. The intention to introduce amendments to the Income Tax Act to impose special reporting requirements for tax shelters was announced in a White Paper released in June, 1987. There was no evidence that the involvement of the tax avoidance section was in any way specific to these particular tax shelters. Nor did such involvement imply that tax evasion was suspected. The defendants, as well as Dr. Sherman, must have been aware from the outset that, in view of the tax benefits to be obtained, investment in the limited partnerships was likely to be regarded by Revenue Canada as aggressive tax planning. In the absence of evidence that the tax avoidance section was engaged because of particular features of these transactions - rather than the fact that they were tax shelters - I do not consider that its involvement should have been considered by the defendants to have represented a significant development.

80 The revision of OCGC's unaudited financial statements for 1986 and a statement in the tax memorandum referring to the payment of interest on indebtedness owing to OCGC were related in that the revision reflected in part, a decision to claim a reserve under a particular provision of the Income Tax Act (Canada). The question whether the existence of the reserve could be reflected in the financial statements was raised with Mr. Title without any discussion of details or figures. Browning was aware that a revision to improve the tax position was contemplated but he had no recollection of having seen the revised unaudited statements for OCGC for 1986 which appeared in the audited statements for 1987 that were signed by OCGC's auditors, Orland & Brass, on November 8, 1988. The auditors presumably saw nothing inconsistent with GAAP in permitting the tax reserve to be reflected in the comparative statements relating to the previous financial year that were contained in the 1987 financial statements and, in Mr. Browning's opinion - supported by that of Dr. Laurence Rosen - the adjustment made for purposes of tax planning would have had no material effect on the ability of OCGC to obtain bank financing when it was explained.

81 Mr. Jack challenged the correctness of the opinions that the changes made to the unaudited statements for 1986 did not reflect any material changes in the presentation of OCGC's actual financial position. There is virtually no evidence that bears on this question other than the internal memorandum of Mr. Browning's colleague that refers to interest owing to OCGC. The memorandum is dated August 10, 1987 and much of it is illegible. It purports to describe five different respects in which OCGC's taxable income might be reduced. The first of these was as follows:

> "The interest on the "second note" has been recognized as income. These notes appear to be "soft loans" as there is a good possibility the interest will never be paid. On this basis, we are suggesting that a reserve for this interest be set up under section 20(1)(l). This will reduce 1985 income by approximately $1.5 million and in 1986 something over $ 9 million."

82 No clear explanation was provided for the statement that there was a good possibility that interest on the second note would never be paid. The note referred to was one of the two given by the limited partners - including Dr. Sherman - to OCGC in respect of amounts advanced by them to assist in the purchase of units. The note provided for interest payments but it was clear from the outset that such payments were not intended to be made by the limited partner. In a reporting letter of December 31, 1985 with respect to Dr. Sherman's subscription for the units of Great Gatsby, his solicitors stated that the payments under the second note were "to be made by the partnership and added to its expense. The partnership's deficit, if any, is covered by OCG pursuant to the Agreement for Providing Line of Credit Agreement". This does not explain why the interest payments might not ultimately be made by the limited partnership.

83 Each of Mr. Title and Mr. Browning insisted that the write-downs for tax purposes had no bearing on, or relation to, the financial health of OCGC. Dr. Laurence Rosen expressed the same opinion. I believe the most likely explanation of the statement in the memorandum is that the tax benefits of investing in the partnerships would be greatest in the early years: that it was contemplated - though nowhere stated in the offering memorandum or in the reporting letter - that investors seeking to shelter income would exercise an option granted to them to require OCGC to purchase the units after five years and that, during the intervening period, the interest payments would, as the reporting letter stated, be covered by a line of credit provided to the limited partnerships by OCGC. The alternative explanation suggested by Mr. Jack would require me to accept that, in the opinion of the accountants, the limited partnerships would be in such financial difficulties that they would not be able to pay their debts as they fell due. If that was, indeed, the view of the accountants, I find it difficult to see how they could have avoided attaching a going-concern note to the financial statements of the partnerships that would represent an opinion that the limited partnerships would not be able to continue as going concerns. However, it was inconsistent with the evidence of Messrs. Browning and Title that the tax planning did not reflect an opinion that the limited partnerships were in financial difficulties. Mr. Irving Rosen may have agreed as he testified that the memorandum would not, by itself, set off alarm bells. The most important consideration is, however, that it is impossible to accept an interpretation of the memorandum that would imply that, in August 1987, the defendants were recommending to OCGC that its financial statements should be prepared on a basis that implied that the limited partnerships were not going concerns - a basis that would, in effect deny their tax efficacy.

84 In his closing submissions, Mr. Jack concentrated heavily on the ability of OCGC to obtain financing for the construction of the yachts, and for the expenses involved in equipping, crewing and chartering them. The successful operation of the businesses for which the limited partnerships were purportedly established, and the entitlement to obtain tax benefits dependent on the existence of a reasonable expectation of profit, were conditioned on this. In view of the warning signals they had received from the information provided to them, the defendants had, in Mr. Jack's submission, an obligation to make inquiries into the financing arrangements made by OCGC and they were negligent in not doing this.

85 It was, I believe, essential to Mr. Jack's submission that it is reasonable to infer that, if such inquiries had been made, the accountants would have concluded that the prospects for obtaining financing were sufficiently remote to require this to be communicated to the limited partners by means of a note to the financial statements, or otherwise.

86 In support of this position, Mr. Jack referred to the fact that, in 1990, Orenstein & Partners was retained by Mr. Scace to provide an opinion whether particular alleged financing arrangements for OCGC were in place. The investigation was conducted by Mr. Title and, in a letter dated August 20, 1990, he reported that, having reviewed specific documentation that had been provided by OCGC in support of the alleged financing - and having made inquiries of Bellfield and others and reviewed further documentation provided by them - his firm had not found "reliable, independent, assessable evidence" in support of the alleged arrangements.

87 Although described as a review "consisting primarily of enquiry, analytical procedures and discussion", the exercise performed by Mr. Title was, in reality, an investigation into the genuineness, veracity and accuracy of the documentation and the representations made by management that was more thorough and penetrating than that which, according to the evidence in this case, would be required for a review engagement. This finding is supported by the evidence of Dr. Laurence Rosen. Even if I were to ignore the fact that the defendants were engaged to review the financial statements of the limited partnerships and not those of OCGC, I would be far from satisfied that an engagement review of OCGC's financial statements - conducted in accordance with the principles in the CICA Handbook in the early months of 1988 - would have arrived at the same conclusion, and could not have been frustrated by further fraudulent, but plausible, representations made by Bellfield.

88 In this connection, I note that OCGC's audited statements for 1987 referred to the contingent liabilities of the corporation in respect of the limited partnerships and to two lines of credit of $82,821,254 and $160,989,071 that are stated to have been arranged for the construction of yachts and the operation of the chartering business, respectively. There was no going-concern note and, subject to the question of the transfer of funds that the auditors had been unable to verify, they attached their opinion that the statements fairly presented the financial position of the company as at October 31, 1987 in accordance with GAAP.

89 I am, of course, not concerned with the question whether the auditors properly performed their obligations to the shareholder of OCGC, or anyone else. In Mr. Jack's submission, the information obtained by Messrs. Browning and Title about the corporation's financial position was such as to require them to make inquiries relating to its ability to obtain financing. I do not believe the information I have already referred to was sufficient to require them to make such inquiries. The need for financing was evident from the outset. In an opinion letter of December 13, 1985 addressed to Bellfield, Mr. Browning had referred to OCGC's insufficient resources to fund partnership losses "as it operates as a conduit for third party financing". This letter had been reviewed by Mr. Title. In my judgment, none of the matters I have referred to altered the position materially or cast doubt on OCGC's ability to obtain such financing. The additional information on which Mr. Jack relied consisted of certain statements in a draft response to Revenue Canada prepared by OCGC's employees and forwarded to Mr. Browning for his comments on November 20, 1987.

90 The draft response refers to difficulties that had been experienced in obtaining construction financing. One of these was the reluctance of conventional lenders to advance such funds before take up financing had been arranged. The response indicates that this problem had been surmounted but that the yacht builder had not commenced to draw down "as the take up financing has not yet been put in place".

91 Neither of the expert witnesses suggested that great significance should be given to this particular response. Mr. Jack, however, submitted that it indicated that take-out financing had not been obtained, that construction of the yachts had not commenced and that these matters should have prompted further inquiries from Mr. Title if he had been aware of the contents of the response.

92 The draft response related to the fiscal years 1985 and 1986 and it is not clear to what extent it purported to address the stage at which financing, or construction, had reached by the end of 1987. However, I believe it is a sufficient answer to Mr. Jack's submission that, in the course of his review of the 1986 and 1987 statements, Title made inquiries with respect to the delays in the construction of the yachts and had received plausible answers relating to the bankruptcy of the original shipbuilder and the substitution of another and the fact that these developments, and the consequential delays, had been explained to the limited partners in a newsletter dated December 5, 1986. Title had been informed that delivery of the boats would commence in 1989. He had decided that on the basis of the information he had received - and notwithstanding the delays - there was no reason to doubt that the limited partnerships would be able to pay their debts as they fell due. After discussions with Mr. Browning, he concluded that a going-concern note would not be appropriate for the 1987 statements.

93 If hindsight is to be excluded, I do not believe Mr. Title can legitimately be criticized for finding nothing suspicious - or unworthy of belief - in the responses provided by OCGC's management to his inquiries. Nor do I believe that the evidence indicates that his initial enquiries fell short of the standards set out in section 8900.19 of the CICA Handbook. Although the question of the viability of the businesses of the limited partnerships as going concerns was not addressed in the Handbook for the purpose of review engagements, it was considered by Mr. Title and, in the exercise of his professional judgment, the general standards applicable to review engagements required neither a going-concern note nor any further inquiries. I see no reason to conclude that he misunderstood those standards or that he failed to exercise reasonable care and diligence in their application.

94 Overall, I find that the plaintiff has not discharged the burden of proving that the defendants' conduct was in breach of the professional standards applicable to the performance of their services with respect to the limited partnerships. I have no difficulty in concluding that they owed Dr. Sherman a duty of care but a finding that they were in breach of that duty would not, in my judgment, be justified in the light of the professional standards relating to review engagements prior to 1989. As the evidence of the expert witnesses demonstrates, adherence to those standards on particular facts necessarily involved questions of judgment on which careful and reasonable chartered accountants might differ. A finding that the defendants were in breach of the standards on the facts of this case would, I believe, involve an inappropriate, and unacceptable, decision to substitute my judgment for theirs'.

95 The plaintiff evidently decided that it would be a fruitless exercise to attempt to recover on the guarantees he had extracted from OCGC and Bellfield and that the defendants were likely to possess a more capacious pocket. He was, of course, entitled to do this but, to succeed, the fact that he may have been defrauded by Bellfield is not to the point. He was required to prove negligence in the performance of the defendants' professional responsibilities and not merely an exercise of judgment with which reasonable accountants might disagree. In the light of the evidence of accounting principles applicable to review engagements in the period in question, I believe the area in which reasonable accountants might reach different decisions was not negligible. 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.

(c) Negligent provision of services: causation

96 If, contrary to my view, the defendants had breached the applicable standard of care, it would still have been necessary for Dr. Sherman to have discharged the burden of proving that the defendants' negligence caused the loss for which he seeks to recover damages. On the basis of the evidence, I am not prepared to find, on a balance of probabilities, that the likely response to any further inquiries the defendants might have made from the auditors, or the management, would have justified the addition of a going-concern note. The auditors were satisfied with the information they had received from management and there is no reason to suppose that Title would have received any different response. As section 8900 of the CICA Handbook recognized, a review engagement was not designed to detect fraud.

97 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.

98 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.

(d) Liability for negligent misrepresentation

99 In Hercules, the Supreme Court of Canada rejected the proposition that the Anns/Kamloops test for identifying duties of care was inappropriate to cases of negligent misrepresentation. La

Forest J. added:

> "This is not to say, of course, that negligent misrepresentation cases do not involve special considerations stemming from the fact that recovery is allowed for pure economic loss as opposed to physical damage. Rather, it is simply to posit that the same general framework ought to be used in approaching the duty of care question in both types of case. Whether the respondents owe the appellants a duty of care for their allegedly negligent preparation of ... audit reports, then, will depend on (a) whether prima facie a duty of care is owed, and (b) whether that duty, if it exists, is negatived or limited by policy considerations." (at page 186)

100 The first branch of the test was said by the learned judge to require "proximity" determined by reference to criteria relating to reliance: namely, whether the defendant ought reasonably have foreseen that the plaintiff would rely on his or her representation and whether such reliance would have been reasonable in the particular circumstances of the case.

101 With respect to the second branch of the test, the fundamental policy consideration that must be addressed in negligent misrepresentation actions centres around the possibility that the defendant might be exposed to liability "in an indeterminate amount for an indeterminate time to an indeterminate class": Hercules, at page 192, citing Cardozo C.J. in Ultramares Corp v. Touche 174 N.E. 441 (1931), at page 44, La Forest J. stated that such concerns should not arise:

> "... in cases where the defendant knows the identity of the plaintiff ... and where the defendant's statements are used for the specific purpose or transaction for which they were made. ... (In) such cases, policy considerations surrounding indeterminate liability will not be of any concern since the scope of liability can readily be circumscribed. Consequently, such considerations will not override a positive finding on the first branch of the Anns/Kamloops test and a duty of care may quite properly be found to exist." (at page 198)

102 If Mr. Jack was correct in his submission that the financial statements contained an implied misrepresentation with respect to the viability of the businesses to be conducted by Great Gatsby and Elegance, I would have no hesitation in finding that each of the branches of the Anns/Kamloops test has been satisfied. Reliance by a limited partner on such a misrepresentation ought reasonably to have been foreseen and would have been reasonable. Indeterminate liability is not, in my opinion, a valid concern where the reliance would have been that of a limited partner for whom the financial statements containing the alleged misrepresentation were prepared and where the alleged misrepresentation related to the interests of such person as a limited partner.

103 However, I do not believe the addition of the claim for negligent misrepresentations assists the plaintiff. The misrepresentation is alleged to relate to "the true state of affairs pertaining to Gatsby and Elegance". I understand this to refer to an implied representation that there were no facts that gave rise to a reasonable inference that the limited partnerships were not going concerns, or otherwise would not achieve their intended objectives. It follows from my reasons above that, if such a representation was made, I am satisfied that it was not made negligently.

104 The plaintiff had no reason to expect that, in performing their responsibilities with respect to the preparation, form and content of the financial statements, the defendants would adhere to a standard of care higher than that already discussed. Any representation necessarily implicit, or inherent, in a reasonable performance of those responsibilities could not, I believe, have been negligently made.

105 I should add that, if it were necessary to consider the question of reliance, I would not have accepted Dr. Sherman's evidence that he relied on the absence of a going-concern note in the financial statements of the limited partnerships. I am not satisfied that he ever read - let alone relied on an implied representation in - the financial statements. He had obtained advice from his personal advisers before subscribing for units of Great Gatsby and they had secured for him a personal guarantee of Bellfield that he would receive the desired tax results. He referred to the existence of this guarantee as a reason for never asking to see the financial statements of OCGC even though, pursuant to the settlement agreement of April 1986, these were to be provided to his accountant annually. There was no persuasive evidence that, after making the investments, he paid any further attention to them before 1989. The burden of proving reliance was on him and, in my judgment, it was not discharged. 5. Damages

106 The damages claimed by the plaintiff related to his interest payments to OCGC in the period after April, 1988 and before January, 1990. In the aggregate, these amounted to $634,996.80.

107 Ms. Perfetto submitted that, in the event that findings of liability were made against the defendants, the damages claimed should be considered excessive for two reasons. The first was that, as a result of the settlement reached with Revenue Canada, the plaintiff had obtained tax benefits that should be deducted in arriving at the damages that flowed from the defendants' breach of duty. She submitted, further, that, by continuing to make payments to OCGC until the end of 1989, the plaintiff had failed to mitigate his damages.

108 If a finding of liability had been made, I would have accepted the principle that tax savings that flowed from the plaintiff's continued payments of interest should be considered to reduce the loss he suffered. In reaching that conclusion, I would have followed decisions such as Toronto-Dominion Bank v. Peat Marwick Thorne (1997), 33 O.R. (3d) 696 (G.D.); Brady v. A. E. Le Page (British Columbia) Ltd (1989), 35 B.C.L.R. (2d) 378 (C.A.) and Jacks v. Davis (1980), 112 D.L.R. (3d) 223 (B.C.S.C.), affirmed (1983), 141 D.L.R. (3d) 355 (C.A.). I note that, in the first of these cases, as well as in Hodgkinson v. Simms, the principle was considered to be as applicable to cases of breach of fiduciary duty as to other cases.

109 However, the evidence relating to the settlement with Revenue Canada and its effect on the tax position of Dr. Sherman, falls short of establishing that he obtained any tax benefit from the continued payments of interest. The deductions he had claimed for the purpose of computing his income were disallowed and, although interest on unpaid tax was waived - or, if paid, refunded - by the Crown, this was in the context of a settlement that related to the totality of the deductions and partnership losses he had claimed with respect to the investments. In my judgment, the evidence is insufficient to establish that tax benefits were derived by Dr. Sherman the payments of interest from that, for the purpose of this part of my reasons, I must assume were caused by the defendants' breach of duty. If, contrary to that conclusion, I should find that there were probably some benefits, I am unable to discern any principled, or practical, method of quantifying them; cf., Perry v. Clintar Ltd. (1996), 41 C.B.R. (3d) 90 (Ont. C.A.).

110 I referred earlier in these reasons to Dr. Sherman's passivity and inaction with respect to his investments in Great Gatsby and Elegance. It does not follow that, by continuing to make payments until the end of 1989, he should be held to have failed to mitigate his damages. The question is whether any part of his loss would have been avoided if he had acted reasonably. That, in turn, depends on whether it would have been reasonable for him to repudiate his contractual obligations before the end of 1989 when he declined to provide post-dated cheques for the coming year. Dr. Sherman is, of course, entitled to have the question decided without the benefit of hindsight.

111 The critical period is, I believe, that between his receipt of Revenue Canada's letter of June 15, 1989 and January 1, 1990. Before the first of those dates, Dr. Sherman was aware that a tax audit was being conducted but it was not unreasonable for him to wait until the outcome was known. I see no reason to reject his evidence that his note referring to the possibility of terminating the interest payments was unlikely to have been written before his receipt of Revenue Canada's letter of June 15, 1989. The position, thereafter, was arguably different not only because of Revenue Canada's decision to assess but, also, because Dr. Sherman was notified that, in the opinion of the department, the structure of the investments lacked legal substance. In the letter of June 15, 1989, Revenue Canada stopped short of saying that the limited partnerships and the accompanying transactions were shams - but not by much. However, its decision to assess did not determine the legal rights of Dr. Sherman vis a vis the Crown. It was the beginning of a procedure that provided for the possibility of objections, internal reviews and appeals.

112 Dr. Sherman chose to refer the matter to his tax advisers and, while they were reviewing the issues - and, presumably, speaking to officials of Revenue Canada - he made no attempt to stop payment on the post-dated cheques he had provided to OCGC for the monthly payments for the remainder of the year. By the end of the period he had received information that suggested that a fraud may have been perpetrated. He had no recollection whether the information was provided by Mr. Florence, or whether it was obtained from a variety of sources including the reactions of other investors. It was, however, sufficient to convince him to send no post-dated cheques for the following year. There is no evidence that he had any reason to doubt Bellfield's bona fides before this time and, in the absence of any such reason, I find it was not unreasonable for him to permit payments to continue on the cheques he had provided for 1989. He had legal representation when he subscribed for units in 1985 and assumed the obligation to make the monthly interest payments. I am not prepared to find that, in the absence of evidence of misrepresentations by Bellfield, Dr. Sherman acted unreasonably in continuing to honour his contractual obligations.

113 For these reasons, I would not find that Dr. Sherman failed to mitigate his damages and, if the liability of the defendants had been proven, I would have awarded him damages of $634,996.80 together with prejudgment interest.

6. Judgment

114 In view of my findings on the question of liability, the action is dismissed. Costs may be spoken to or, if counsel would prefer to make their submissions in writing, the defendant should do so within 21 days of the release of these reasons and those of the plaintiff should be delivered within a further 14 days.

CULLITY J.

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