

We've all heard the proverbial story about the fellow who spills hot coffee in his lap at a restaurant and then promptly seeks compensation from anyone even remotely connected to the incident, suing everyone from the restaurant and its staff to the coffee supplier. Well, stories like that one really happen. And in recent years, the number of massive lawsuits in the financial services industry has been skyrocketing, predicated on joint and several liability laws, under which each defendant in a lawsuit is liable for the entire amount of damages regardless of fault. It's not only defendants paying the price. The costs are also rising for Ontario's economy and competitiveness.

TIME FOR CHANGE? JOIN THE DIALOGUE.

LEGAL LIABILITY REFORM



To understand the impact of 'joint and several liability' on Canada's financial services sector, imagine the state of our society if it were common for courts to rule that the local police force was responsible for damages each time a home was robbed or a car stolen.

"Even if it turns out that you had an alarm and the police didn't arrive in time to stop the robbery, would you really consider it proper to get 100 per cent of the reimbursement from the local policeman rather than from the fellows who stole your TV set? I don't think that many of us would think that's fair," says Mindy Paskell-Mede, a lawyer whose practice is principally focused on liability defence and coverage litigation.

Beyond the issue of rationality, of course, is the inevitable result: our police forces would quickly be out of funding. Similarly, joint and several liability threatens Canada's financial services providers and, ultimately, our competitiveness in global markets.

"Joint and several liability affects a wide range of organizations because it heightens the risk of doing business in this country," says Brian Hunt, president and CEO of the Institute of Chartered Accountants of Ontario. "If you are found partially responsible for a loss in a court case, it's possible that you'll be held responsible for all damages if other parties are not able to pay their share."

"This is particularly tough for firms providing financial services because most companies have relationships with organizations providing services related to audit, assurance or tax work. If, for example, a claimant files a suit against a business that has been audited, joint and several liability incents them to name the auditors in the action because they represent another option for collecting damages."

"Joint and several liability unduly increases audit costs in a number of ways, costs that are inevitably passed onto our clients," says Lou Pagnutti, chair and CEO of Ernst & Young LLP. "Public accounting firms are compelled to settle litigation rather than risk award damages that could be catastrophic; professional indemnity insurance to insure against large risk, or catastrophic risk, is either not available or prohibitively expensive; and the cost of litigation and the time spent on it is clearly excessive."

But the effect is much broader than the increased costs that businesses face as audit costs rise, says Mr. Pagnutti. "We can deal with cost. The bigger concern is uninsurable catastrophic risk and the sustainability of our profession here in Canada, in Ontario and globally. Having an appropriate liability regime would help improve choice for many companies, and that is, without question, a positive thing."

It is not, he says, "a system that is as fair as one would expect in a modern open economy. A proportionate liability system, where each party is responsible for his or her degree of fault, creates an efficient and a fair result. It also creates the right framework for our capital market, because in the world we live in today, you want to ensure that your province and country are viewed as a good place to invest."

Other countries are also grappling with joint and several liability regimes,

but are moving more quickly to modernize legislation, leaving Canada at a competitive disadvantage.

Richard Hardingham, an underwriter with Brit Syndicate at Lloyd's of London in the U.K., says, "With claims I've seen over the years, the trend has been that when a major insolvency occurs, the plaintiffs have settled first with defendants such as directors, officers and lawyers, who usually have relatively low limits of coverage. With the money they have gained from those settlements, an action is mounted against the perceived richer source of compensation – the major accounting firm."

In the U.K., where regulators addressed this issue in the Companies Act of 2006, auditors now contract annually with shareholders to limit liability to a 'fair and reasonable amount.'

Legislative change has also taken place in the U.S. with the 1995 Private Securities Litigation Act that raises the standard for a third party plaintiff in making a claim against an accounting firm, and most U.S. jurisdictions have adopted proportionate liability. But because proportionate liability has not yet been enacted by Canadian regulatory regimes and the U.S. is perceived as being a litigious environment, the trend is for insurers to avoid North America. "New players come in from time to time but often withdraw after a couple of years when they become disillusioned with the outcome of liability claims," notes Mr. Hardingham.

"We all agree there should be a level of exposure, but it has to be based on a system of proportionality," says Mr. Pagnutti. "We should be held responsible for our degree of fault, but being held responsible for 90 per cent of the costs when you're 10 per cent at fault doesn't in any way enhance (audit) quality." □

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ABOUT ONTARIO'S FINANCIAL SERVICES SECTOR

Ontario's financial services sector is a vital part of the provincial economy. Financial services providers, including CA firms large and small, contribute almost eight per cent of Ontario's GDP and employ 220,000 people in the sector, many in well-paying, high-value jobs in the Greater

Toronto Area and in communities across the province.

The impacts of an increasingly globalized economy are making the international competitiveness of Ontario's financial services sector critical not only to the province, but also Canada.

Just like other industries, Cana-

da's financial services sector needs to keep up with a fast-changing world where cities and countries are vying for head offices, investment and top business professionals.

Today, many financial services can be provided from anywhere that has achieved a critical mass of talent. Firms based in Canada can, and

do, provide services in other jurisdictions, but the reverse is also true.

To protect our competitive position and to continue to develop our domestic roster of financial services professionals, it is necessary to create and maintain a business environment that meets or exceeds that of our international competitors. □

INSIDE

CA2 PEOPLE & SERVICES

Ontario's competitiveness depends on business growth, and funding that growth depends on access to finance and accounting services. Bay Street weighs in on the impacts of joint and several liability, which range from discouraging top professionals from providing these services to needless risk-aversion in the financial services sector.

CA2 THE LITTLE GUY

Ontario's legal liability regime is hindering the ability of small and medium-sized businesses to innovate, create jobs and compete in a global marketplace. While companies in this province face impeded access to necessary finance and accounting services and higher costs, it's a different story in competing jurisdictions.

CA3 AN EDUCATED VIEW

IAN LEE, PHD, Director of MBA Programs at the Sproull School of Business at Carleton University, says while expectations drive us higher – or in the words of the Olympic motto, "Citius, Altius, Fortius" – swifter, higher, stronger – they can also lead to risks, especially when ever-higher expectations become unrealistic and demand a risk-free world.

CA4 LESSONS FROM THE U.S.

LAWYER CHARLES J. HECHT, Principal of Hecht & Associates, P.C. of New York, writes that while recent court decisions and legislative changes in the U.S. are improving the situation in America, the impacts of disproportionate liability faced by U.S. accounting firms have resulted in significant effects that continue to resonate well beyond the financial services sector.

CA4 THE INSURANCE EFFECT

Unable to quantify the risk, insurers are thinking twice about providing coverage to financial services firms. While the largest firms turn to self-insurance to meet this challenge, smaller firms lack the resources to do the same. The bottom line: Because of risk, access to audit services is becoming constrained, affecting businesses of all sizes.

CA5 JOIN THE DISCUSSION

BRIAN HUNT, FCA, President and CEO of the Institute of Chartered Accountants of Ontario, offers perspective on Canada's need for legal liability reform, an issue that has been discussed in countries around the world for decades. He explains why Ontario's Chartered Accounting profession thinks the time has come to get the discussion started in Canada.

WE COULD SIT BACK, AND WAIT FOR THE URGENT CHANGES YOUR BUSINESS NEEDS. BUT WE'RE CHARTERED ACCOUNTANTS.

Ontario CAs are calling for changes to the policies that are limiting the competitiveness of your business. Learn more in this special section and at casforchange.ca