M52498

Court of Appeal File No.:
Divisional Court File No.: 058/20

COURT OF APPEAL FOR ONTARIO

B E T W E E N:

ANTHONY WHITEHOUSE,
CARRIE COUCH and JASON COUCH

Plaintiffs
(Appellants)

and

BDO CANADA LLP

Defendant
(Respondent)

NOTICE OF MOTION FOR LEAVE TO APPEAL

The Plaintiffs (Appellants) will make a Motion to the Court of Appeal for Ontario to be heard in writing, at Osgoode Hall, 130 Queen Street West, Toronto, Ontario, M5H 2N5, on a date to be fixed by the Registrar from the Order of the Divisional Court dated April 20, 2021.

PROPOSED METHOD OF HEARING: The Motion is to be heard in writing pursuant to Rule 61.03.1

THE MOTION IS FOR

(a) Leave to appeal the Order of the Divisional Court dated April 20, 2021 dismissing an appeal from the Order of Perell J. dated January 8, 2020 dismissing the Appellants' motion for certification of this action as a class proceeding;

(b) The costs of this motion; and

(c) Such further and other Relief as to this Honourable Court may seem just.

THE GROUNDS FOR THE MOTION ARE

3. The Appellants were investors in Crystal Wealth, a now-defunct mutual fund investment company that was looted by fraud. Investors in those funds lost tens of millions of dollars. The Appellants seek to certify this action as a class proceeding against the auditor of the Crystal Wealth funds, the Respondent, BDO Canada LLP ("**BDO**").

I. The Parties

4. The respondent, BDO, is a national assurance, accounting, tax and advisory firm. It was the sole auditor for Crystal Wealth and its Funds (as defined below) from 2007 until the Ontario Securities Commission (the "**OSC**") obtained a cease trade order in on April 7, 2017.

5. The appellant, Anthony Whitehouse, invested his entire life savings of nearly $1 million in five of the Funds. The appellants, Carrie and Jason Couch similarly invested their entire life savings of nearly $600,000 in three of the Funds.

6. Mr. Whitehouse and the Couches are the proposed representative plaintiffs for a class action on behalf of the following proposed class: any person who invested in any of the Funds of Crystal Wealth from April 12, 2007 to April 7, 2017, and who retained investments in any of the Funds on April 7, 2017, excluding certain individuals and entities that are related to Crystal Wealth and BDO, among others.

II. Crystal Wealth

7. From 2007 to 2017, Crystal Wealth created, marketed and managed proprietary funds, structured as open-ended mutual fund trusts (the "**Funds**"). Units in the funds were distributed to unitholders on an exempt-market basis, pursuant to offering memoranda.

8. Critically, unlike shareholders in a company, unitholders did not have the right or ability to vote in respect of their units. Their ability to protect their investment was limited to deciding whether to hold or sell their units.

9. The applicable securities laws required Crystal Wealth and each of the Funds to prepare annual audited financial statements, which were required to be (a) filed with the OSC, and (b) sent directly to every unitholder in the Fund.

10. Crystal Wealth retained BDO to audit the Funds. Over the course of nearly a decade, BDO provided clean audit opinions in respect of all the Funds that were in existence at the relevant times. By 2015, there were ten Funds and BDO issued clean audit opinions for all of them. BDO was also engaged to audit five additional funds that were created in 2016, but it did not deliver audit opinions for those funds.

11. BDO's engagement letter with Crystal Wealth specifically provided that "[o]ur Services will not be planned or conducted in contemplation of or for the purpose of reliance by any third party other than you and any party to whom the assurance report is addressed." Critically, the assurance reports in the financial statements were addressed directly to the "Unitholders" of the Fund in question.

III. The Appointment of a Receiver over Crystal Wealth

12. Crystal Wealth and its funds failed to deliver their audited financial statements for the year ended December 31, 2016 by the deadline of March 31, 2017.

13. On April 7, 2017, the OSC obtained a temporary cease trade order prohibiting trading in the Funds' units. On April 26, 2017, Grant Thornton LLP was appointed as receiver (the "**Receiver**") over all assets of Crystal Wealth and the Funds. As a result, unitholders have been unable to redeem their units in the Funds since April 7, 2017.

14. Shortly after it was appointed, the Receiver found that Crystal Wealth "disclosed false or manipulated net asset values ("**NAVs**") of the Funds, causing the NAVs of certain Funds to be materially overstated", and that the inter-fund investments "may have been used to falsely create liquidity to meet investor distributions and/or redemptions".

15. Following the appointment of the Receiver, the directing mind of Crystal Wealth admitted in a settlement with the OSC to committing fraud and misappropriating millions of dollars of investor money from two of the Funds. Because there was significant inter-fund investment, most if not all of the other funds were also impacted.

IV. BDO Caused Damage to the Proposed Class

16. BDO failed to identify the issues with the Funds, and it continued to deliver clean audit opinions year after year. That was a proximate cause of substantial unitholder losses. BDO's clean audit opinions were critical to the growth of Crystal Wealth and the proliferation of the Funds: they allowed Crystal Wealth to solicit new investments based on inflated representations of its NAVs, and they deprived unitholders of the ability to make informed investment decisions.

17. Without BDO's negligent audits, unitholder losses would have been limited and, in some cases, prevented altogether.

V. Perell J. Incorrectly Finds that the Claim Does not Disclose a Reasonable Cause of Action

18. Perell J. determined that the cause of action criterion for certification under section 5(1)(a) of the *Class Proceedings Act* was not satisfied because he found it was "plain and obvious" that BDO did not owe a duty of care to the unitholders of the Funds.

19. Perell J. held that the interposition of the OSC between BDO and the class members made the relationship too remote to ground a duty of care. He held that the unitholders of the Funds did not rely on BDO directly, but rather on its statutory audits, such that this case was similar to or on all fours with decisions on the merits by the Supreme Court of Canada in *Hercules Management Ltd. v. Ernst & Young* and by the Ontario Court of Appeal in *Lavender v. Miller Bernstein LLP*.

20. Perell J. concluded that "the statutory scheme cannot be seen as the basis of a duty of care to the investors in making investment decisions [or]…as the basis for a duty of care to ensure that Crystal Wealth complied with Ontario's securities laws such that the OSC would permit it to continue to offer and redeem units in the mutual funds."[57] In short, he determined that the *Hercules* and *Lavender* decisions establish that there is no duty of care owed to investors arising from a statutory audit.

21. Perell J. specifically held that but for the failure to satisfy the cause of action criterion under section 5(1)(a) of the *CPA*, he would have certified the action as a class proceeding, albeit with some qualifications.

VI. The Divisional Court Incorrectly Dismisses the Appeal

22. The Divisional Court held that Perell J. did not err as a matter of law in finding that the Appellants did not satisfy the cause of action criterion under section 5(1)(a) of the *CPA*.

23. The Divisional Court found that it was plain and obvious that there was insufficient proximity to ground a duty of care for two reasons. First, it found, based on a parsing of the words in the Statement of Claim, that there were no pleaded facts to support the allegations in the Statement of Claim that: (a) BDO delivered its audit opinions for the purpose of allowing unitholders to make investment decisions; or (b) BDO intended for the unitholders to rely on its audit opinions for the purpose of making investment decisions.

24. Second, the Divisional Court found that there was insufficient proximity because the class definition "*could* include" individuals who were not unitholders when BDO delivered its final audit opinion, raising the prospect of indeterminate liability with respect to such individuals. In other words, the Divisional Court was concerned that the class definition was overly broad.

25. The Divisional Court was satisfied, based on *Hercules, Livent* and *Lavendar*, that the law is sufficiently certain to conclude that it is plain and obvious that an auditor does not owe investors a duty of care in respect of statutory audits.

VII. The Proposed Appeal Raises an Arguable Question of Law

26. The proposed appeal raises a pure question of law. Whether a pleading discloses a cause of action is a question of law, and an appeal from a refusal to certify a class proceeding under section 5(1)(a) of the *CPA* is subject to review on the standard of correctness.

27. There is good reason to doubt the correctness of the order of the Divisional Court. There is an arguable case that the Divisional Court erred in its analysis, and that it is not plain and obvious that there is no duty of care owed by BDO to the proposed class.

28. There is an arguable case that the Divisional Court failed to accept the pleaded facts as true and to read the pleadings generously, as required under section 5(1)(a) of the *CPA*.

29. In particular, the Divisional Court found that the alleged undertaking of BDO arises from the statutory requirement for annual audit reports under the *Securities Act* because of "the use of the word '[a]ccordingly' at the beginning of para. 62, which goes on to plead two alleged 'purposes' for the audit".

30. The focus on the word "accordingly" in the Statement of Claim is inconsistent with the requirement to read the pleadings generously. That error caused the Divisional Court to fail to accept as true (a) the pleaded purposes of the BDO audits, including "to allow investors in the Funds to assess the performance of the Funds and fairly value and/or evaluate their investments and to make investment decisions", and (b) BDO's pleaded intention that unitholders would "receive each audit report and rely on it in making investment decisions."

31. There is an arguable case that if the pleadings are given a generous reading and the pleaded facts are accepted as true, the Statement of Claim discloses a reasonable cause of action in negligence.

32. In addition, the Divisional Court arguably erred in finding that the proposed class definition undermined the existence of a duty owed by BDO to the proposed class. The Divisional Court's analysis on that point suggests that it was of the view that the proposed class definition was

overbroad because it could include investors that invested after 2015 when BDO delivered its final audit report. That does not justify its broad conclusion that no duty was owed to any members of the proposed class, including those that invested before 2015.

33. Finally, the Divisional Court arguably erred by failing to appreciate the specific context of the BDO audits at issue in this case. In particular, the Divisional Court found that there was no pleading of material facts to establish an undertaking by BDO to the unitholders that the reports should be used for the investors' individual investment decisions. However, there could have been no other purpose for providing the audit opinions to unitholders. Unlike the shareholders of a company, like those at issue in *Hercules*, the unitholders in this case had no role in overseeing management of Crystal Wealth or the Funds. In other words, the audit opinions could only have been used by unitholders to inform their personal investment decisions. There is no other purpose for which the audit opinions could have been delivered to the unitholders.

VIII. The Proposed Appeal Raises Issues of Public Importance

34. The proposed appeal raises broad issues of public importance, both to the members of the proposed class and to the investing public generally.

35. First, this is an issue of broad public importance to a large member of individual members of the proposed class. It is estimated that the proposed class is comprised of approximately 1,250 unitholders. This is a significant issue for the affected individuals, who have lost substantial amounts of money. The proposed representative plaintiffs have lost much of their life savings. Undoubtedly, a large number of the proposed class members are in the same situation.

36. Recent amendments to the *CPA* provide that appeals from an order certifying or refusing to certify a class proceeding lie directly to this Court. Although the amended provisions are not applicable to this proceeding (which was commenced before the amendments came into force), the amendments represent an acknowledgment by the Legislature that this Court should consider appeals from certification decisions.

37. Second, the proposed appeal raises broad issues of public importance to the investing public generally and to auditors. If allowed to stand, the jurisprudential result of the Divisional Court's decision will be that it is plain and obvious that auditors do not owe a duty of care to investors in respect of statutory audits. This is a significant development in the law of auditor's liability and negligence, which should be considered by the Court of Appeal. This is particularly true given that the existence (or not) of a duty of care in the circumstances has a significant impact on the investing public in Ontario (*i.e.*, everyone that invests in mutual funds and other securities for which there is a requirement for a statutory audit) .

38. The Moving Parties rely on Rules 1.04 and 61.03.1 of the *Rules of Civil Procedure* and s.6(1)(a) of the *Courts of Justice Act*.

39. The Moving Parties also rely on such further and other grounds as the lawyers may advise.

THE FOLLOWING DOCUMENTARY EVIDENCE

1. The Affidavit of Sandara Siyamendo to be sworn;

2. Such further and other evidence as the lawyers may advise and this Honourable Court may permit.

May 4, 2021

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PROCEEDING COMMENCED AT
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