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In 1996, *South Australia Asset Management Corporation v York Montague Ltd* [1997] AC 191 (SAAMCO) laid down the approach to be followed in ascertaining the scope of duty in professional negligence claims. Some 25 years later, the UK Supreme Court has finally handed down its first judgment providing general guidance as to how the SAAMCO principle should be applied in *Manchester Building Society v. Grant Thornton UK LLP*.¹

Grant Thornton UK LLP (**Grant Thornton**) was the auditor of Manchester Building Society (the **Society**). In 2006, Grant Thornton advised the Society that its accounts could be prepared using a method called “hedge accounting” and that such treatment met the relevant regulatory requirements. From 2006 to 2011, the Society adopted this method in preparing its accounting statements.

In reliance on Grant Thornton’s advice, the Society offered lifetime mortgages and entered into interest rate swaps on the basis that such arrangement hedged against interest rate risks. However, during the 2008 financial crisis, interest rates dropped significantly and the Society incurred huge losses in relation to the swaps. By using hedge accounting to prepare its accounts, the volatility in the Society’s capital and hence huge losses in the swaps when compared to the value of the mortgages remained hidden.

In 2013, the Society realised that Grant Thornton’s advice was inaccurate and that it could not rely on hedge accounting. As a result, the Society had to restate all of its accounts to reflect the negative values of the swaps and significant reduction in capital. Thus, the Society was unable to meet the regulatory capital requirement and was forced to close out the swaps early. The Society incurred break costs of £32.7 million and sought to recover these costs from Grant Thornton.

The decision of the High Court

Grant Thornton admitted that it had been negligent in giving accounting advice to the Society but argued that its negligence did not cause the Society’s loss, and that the loss did not fall within its scope of duty owed to the Society.

The High Court held that Grant Thornton’s breach caused the Society to enter into the swap arrangements, and then subsequently break them in 2013. However, it also held that Grant Thornton did not assume any responsibility for the swaps being “out of the money” when they were broken. Instead, a large part of the loss flowed from market forces. Thus, the Society was only able to recover the transaction costs incurred in breaking the swaps.

The Society appealed against the High Court’s decision.

The decision of the Court of Appeal

The Court of Appeal dismissed the Society’s appeal, but adopted a different analysis. It opined that the High Court

had asked itself the wrong question as to whether Grant Thornton assumed responsibility for the Society's losses. The correct question in applying the SAAMCO principle is whether the case is an "information" or "advice" matter. In answering this question, the "purpose and effect" of the advice should be ascertained.

Applying the above principles, the Court of Appeal held that the accounting advice constituted "information", so Grant Thornton was only liable for losses that were foreseeable if the advice was wrong. The Court of Appeal went on to apply the counterfactual test laid down in SAAMCO, which is to ask whether the same loss would not have been suffered if the advice had been correct. The Society failed to prove its loss by applying the counterfactual test, as the discovery of the negligent advice only crystallised the loss suffered by the Society, which would have been suffered anyway if the Society had continued to hold the swaps. Therefore, the Court of Appeal held that the counterfactual test was not satisfied.

The Society appealed against the Court of Appeal's decision.

The decision of the Supreme Court

The Supreme Court unanimously allowed the appeal and held that the loss suffered by the Society was within the scope of duty of care assumed by Grant Thornton, having regard to the purpose of Grant Thornton's advice on the use of hedge accounting. Grant Thornton was held liable for the loss suffered by the Society in the early termination of the swaps, subject to a reduction of damages of 50% because of the Society's contributory negligence.

The majority's analysis started out by identifying six questions to consider when a claimant seeks damages in the tort of negligence:

1. Is the harm (loss, injury and damage) which is the subject matter of the claim actionable in negligence? (the actionability question)
2. What are the risks of harm to the claimant against which the law imposes on the defendant a duty to take care? (the scope of duty question)
3. Did the defendant breach his or her duty by his or her act or omission? (the breach question)
4. Is the loss for which the claimant seeks damages the consequence of the defendant's act or omission? (the factual causation question)
5. Is there a sufficient nexus between a particular element of the harm for which the claimant seeks damages and the subject matter of the defendant's duty of care, as analysed at stage 2 above? (the duty nexus question)
6. Is a particular element of the harm for which the claimant seeks damages irrecoverable because it is too remote, or because there is a different effective cause (including *novus actus interveniens*) in relation to it or because the claimant has mitigated his or her loss or has failed to avoid loss which he or she could reasonably have been expected to avoid? (the legal responsibility question)

This appeal concerned the second question on the scope of duty. The court ruled that the scope of the duty of care assumed by a professional adviser is governed by the purpose of the duty, judged on an objective basis by reference to the reason as to why the advice is being given. In examining allegedly negligent advice given by a professional adviser, the court is required to determine what risk the duty was supposed to guard against and then look to see whether the loss suffered represented the fruition of that risk.

The majority commented that the "advice" and "information" distinction set out in SAAMCO can be problematic as being too rigid – instead, the focus should be on the purpose to be served by the duty of care, having regard to the underlying policy as to the fair and reasonable allocation of the risk of loss as between the parties. As to the counterfactual analysis proposed in SAAMCO, which involves asking whether the claimant's actions would have resulted in the same loss if the advice given by the defendant had been correct in an "information" case, this acts as a

useful cross-check in most cases, but should not be regarded as a substitute for determining the purpose of the advice. This is because the distinction between “advice” and “information” cases can sometimes be unhelpful and the counterfactual analysis is subject to the danger of manipulation.

In this case, the majority of the Supreme Court held that the purpose of the accounting advice was to see whether the Society could use hedge accounting in order to implement its proposed business model using mortgage and interest rate swaps, while satisfying the relevant regulatory requirements. In reliance on Grant Thornton's advice that it could do so, the Society entered into swap transactions and was exposed to the risk of loss from having to break the swaps, when it was required to satisfy the regulatory capital demands which the use of hedge accounting was supposed to avoid. In so concluding, the court considered that Grant Thornton appreciated the commercial reason why the advice was being sought and why this was fundamental to the Society's decision to engage in the business of matching swaps and mortgages.

However, the Supreme Court unanimously found that the Society's damages should be reduced by 50% on the basis of its contributory negligence, because the Society had been overly ambitious in adopting a business model matching swaps and mortgages.

Concurring judgments

In his concurring judgment, Lord Leggatt agreed that the losses suffered by the Society fell within the scope of duty owed by Grant Thornton, but differed from the majority in how Grant Thornton's scope of duty should be determined. His Lordship opined that one should examine whether there is a sufficient causal relationship between what makes the information or advice wrong, and the loss and the foreseeable consequences of the existence of facts or matters which the adviser has misrepresented or failed to report, which makes the information or advice wrong. Care is also required to ensure that the assumptions adopted in the counterfactual test are suitable to reflect the allocation of risk between the parties and, in some cases, a counterfactual test cannot readily be applied.

Applying the principles to the facts of this case, Grant Thornton had advised that there was an effective hedging relationship between the fair value of the swaps and the impact of movements in interest rates on the value of the mortgages, and such advice was wrong. By applying the counterfactual test in this case, Lord Leggatt determined that the fault in the advice had caused the Society's £32.7 million loss, because if Grant Thornton's advice had been correct and there had been an effective hedging relationship, the fair value of the swaps would have been offset by the corresponding difference in the fair value of the mortgages. As the requirement of causation was satisfied, his Lordship concluded that Grant Thornton was liable for the loss incurred by the Society in respect of the costs of closing out the swaps.

Conclusion

This is a significant Supreme Court decision on the determination of the scope of duty in professional negligence cases. The new approach set out by the Supreme Court potentially allows more room for a claimant to bring claims against their negligent professional advisers. One of the implications is that, going forwards, professional practitioners should be more vigilant in asking themselves what risk their advice is supposed to guard against, in order to at least minimise the risk of failing to advise on any ancillary issues which may be said to fall within the scope of duty under a particular retainer. Professional practitioners would also be well advised to document in writing what it is they have been retained to do. Greater care should be taken in defining the scope and purpose of any advice in engagement letters.

In any future litigation, it is expected that the following key questions will be determined on a case-by-case basis

depending on the specific factual circumstances of each case:

- i. The purpose for which advice was given;
- ii. The risk which the professional practitioner's advice is supposed to guard against; and
- iii. Whether the loss suffered represents the fruition of that risk.

There may still be some uncertainty in the practical application of the legal principles established by *Manchester Building Society v. Grant Thornton UK LLP*, particularly where advice is given in a case involving complicated facts and/or multiple transactions, such that it may not be straightforward to analyse the same and ascertain the answers to the above questions.

The Supreme Court decision will be of persuasive authority in the Hong Kong courts in future professional negligence cases, and professionals and their insurers should have regard to it.

1. [2021] 3 W.L.R. 81.

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