EXCHANGE
CHAMBERS

Manchester Building Society v Grant Thornton UK LLP [2021] UKSC 20

Giles Maynard-Connor QC and Jodie Wildridge

Introduction

Briefly put, the House of Lords decision in *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd: South Australia Asset Management Corpn v York Montague Ltd* [1997] AC 191 ('SAAMCO') is authority for the application of a counterfactual test in the determination of whether a claimant's loss falls within the scope of a professional's duty of care. The starting point is to ascertain whether the professional's duty was to give *'advice'* (in which case the counterfactual test does not apply and the scope of the duty of care extends to the recovery of all factually caused losses subject to the standard limitations of remoteness and legal causation) or whether the duty was to provide *'information'* only (in which case the scope of the duty of care is limited to the recovery of loss consequent on the information being wrong).

In the first case to have reached the Supreme Court on the applicability of SAAMCO to an auditor's negligence, the expanded, seven-Judge constitution[1] took the opportunity in the case of *Manchester Building Society v Grant Thornton UK LLP* [2021] UKSC 20 to provide *'...general guidance regarding the proper approach to determining the scope of duty and the extent of liability of professional advisers in the tort of negligence'*[2].

Facts

In April 2006, Grant Thornton UK LLP ('Grant Thornton') advised Manchester Building Society ('the Society') that the Society was entitled to have its accounts prepared by way of a method known as 'hedge accounting'; and that such would give a true and fair view of the Society's financial position thereby satisfying the applicable regulatory requirements. Further, between December 2006 and December 2011, Grant Thornton applied this method of hedge accounting in preparing the Society's accounts.

In reliance upon Grant Thornton's advice, the Society formulated a business plan by which it entered into interest rate swap agreements as a hedge against interest rate changes affecting its central lending and mortgage business. In fact, the accounts prepared using hedge accounting served to obscure the true financial position of the Society; hiding volatility in the Society's capital position and what became a severe mismatch between the negative value of the swaps and the value of the mortgage loans which the swaps were supposed to hedge.

In March 2013, Grant Thornton informed the Society that its advice on hedge accounting had been incorrect; the result of which was that the Society had to restate its accounts, which showed substantially reduced net assets and insufficient regulatory capital.

With the encouragement of the regulator, the Society therefore closed out the swaps in June 2013 and incurred break costs of c.£32m in doing so. The Society sought to recover the same from Grant Thornton.

The Decision of the High Court: [2018] EWHC 963 (Comm)

Whilst admitting to having given negligent advice,[3] the claim was defended by Grant Thornton on the grounds that its negligence did not cause the losses claimed by the Society and/or that those losses were not recoverable in law because they were not losses which Grant Thornton owed the Society a duty to protect against.

Following a 17-day trial in the Commercial Court, Teare J, in reliance on SAAMCO, held that the c.£32m cost incurred by the Society in terminating the swaps flowed from market forces for which Grant Thornton had not

assumed a responsibility to the Society[4]. On that basis, damages to the Society were awarded in the sum of only £316,845 plus interest[5].

The Society appealed to the Court of Appeal.

The Society's Appeal to the Court of Appeal: [2019] EWCA Civ 40

The Court of Appeal dismissed the Society's appeal; agreeing with Teare J that the c.£32m cost incurred by the Society in terminating the swaps was irrecoverable pursuant to SAAMCO. The basis relied upon by Hamblen LJ, however, was that the scope of Grant Thornton's duty was to provide *'information'* only, not *'advice'*, and that the Society had failed to satisfy the burden of proof in relation to the counterfactual test as required by SAAMCO[6].

The Society's Appeal to the Supreme Court: [2021] UKSC 20

Faced with the question whether the Society's c.£32m loss fell within the scope of Grant Thornton's duty of care, the majority of the Supreme Court[7] confirmed the following:

> ***(i) the scope of duty question should be located within a general conceptual framework in the law of the tort of negligence.***

The conceptual framework, and the place of the scope of duty within it, was set out as follows (emphasis added)[8]:

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)*

> ***(ii) 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 purpose for which the advice is being given…;***

The majority labelled such approach a *'more straightforward'* one[9].

> ***(iii) in line with the judgment of Lord Sumption in Hughes-Holland at paras 39-44, the distinction between "advice" cases and "information" cases drawn by Lord Hoffmann in his speech in SAAMCO should not be treated as a rigid straitjacket;…***

As opposed to starting from the categorisation of a case as one of *'advice'* or *'information'* and *'trying to shoe-horn a particular case into one or other of these categories'*[10], the focus is to be on the identification

of the purpose of the professional's duty.

> ***(iv) counterfactual analysis of the kind proposed by Lord Hoffmann in SAAMCO should be regarded only as a tool to cross-check the result given pursuant to analysis of the purpose of the duty at (ii), but one which is subordinate to that analysis and which should not supplant or subsume it.***

Determining the correct purpose for which the advice was given does not necessitate reliance on the counterfactual test (or often-cited 'SAAMCO cap'); indeed, such *'...has the potential to confuse rather than assist the correct analysis'*[11].

The Supreme Court's Decision

Applying the above principles, the Supreme Court concluded that both Teare J and the Court of Appeal had been wrong to find that the loss sustained by the Society as a result of entering into long term interest rate swaps in reliance on Grant Thornton's negligent advice was not within the scope of Grant Thornton's duty.

Significantly, in disagreeing with the comment made by Teare J, as endorsed by the Court of Appeal; the Supreme Court found it could not accept *'...that there is anything inherently unlikely or surprising'* in reaching the conclusion that an accountant who advises a client as to the manner in which its business activities may be treated in its accounts is legally responsible for the financial consequences of those business activities[12].

In the circumstances, the Supreme Court determined that Grant Thornton's duty to the Society was:

'...solely to ensure that the society had accurate advice about the proper accounting treatment of the mortgages and swaps on which it could rely in taking commercial decisions, including the decisions which the society took to enter into long-term interest rate swaps as a hedge against changes in the fair value of its mortgage loans[13]'.

Further:

1. the risk of the absence of an effective hedging relationship between the swaps and the mortgages which they were supposed to hedge was a risk which Grant Thornton owed a duty to protect the Society against;
2. the cost of closing out the swaps was attributable to that risk; and
3. therefore, Grant Thornton owed a duty to protect the Society against the loss actually incurred[14].

That said, whilst Grant Thornton's advice on hedge accounting was relevant to the Society's decisions to enter into and to continue to hold swaps and lifetime mortgages; other, commercial considerations concerning the costs, risks and benefits of the Society's lending strategy were also at play, which it was not Grant Thornton's responsibility to identify or assess[15]. Accordingly, the Society's own negligence was properly reflected in a 50% reduction in the damages awarded[16].

Conclusion

In moving away from a strict application of SAAMCO, the Supreme Court has proffered a much more straightforward and common-sensical approach to determining a professional's scope of duty.

That said, the test as confirmed by the Supreme Court, namely – *what purpose was the duty of care assumed by the professional objectively intended to serve[17] and was it intended to guard against the loss actually suffered[18]* – will no doubt be the cause of concerns.

It is envisaged that this decision will have wide ranging consequences.

[1] Comprising Lord Reed; Lord Hodge; Lady Black; Lord Kitchin; Lord Sales; Lord Leggatt and Lord Burrows.

[2] ¶1 *Manchester Building Society.* It is made clear (¶2) that the focus of the judgment is on the scope of the duty of care in tort; but that the scope of the parallel duty of care in contract depends on the same factors. The case of *Khan v Meadows* [2021] UKSC 21, concerning the applicability of SAAMCO to a claim for a doctor's negligence was heard in parallel by the same constitution of the Supreme Court. Judgments in both cases were handed down on 18.06.21. Whilst this article focusses on the *Manchester Building Society* case, the Judgment makes explicit that the judgments in both cases ought to be read together (¶2).

[3] The only dispute of primary fact at the trial was whether Grant Thornton was aware in April 2006 that the Society intended to hedge lifetime mortgages by entering into long-term swaps. At first instance, Teare J found in favour of the Society on this issue.

[4] Teare J went on to make further findings, as set out at ¶66 *Manchester Building Society*.

[5] The main item of damages awarded was the transaction costs payable to terminate the swaps early.

[6] Hamblen LJ observed that the Society could not show that it had suffered any loss just by closing out the swaps at their fair value. To show that it suffered a loss by terminating the swaps when it did, the Society would have had to prove that it would have been better off if it had continued to hold the swaps. However, on Teare J's own findings, this had not been proven. The judge had accordingly been correct to dismiss the claim. ¶70 *Manchester Building Society*.

[7] Lord Hodge; Lord Sales; Lord Reed; Lady Black and Lord Kitchen

[8] ¶6 *Manchester Building Society*

[9] ¶13 *Manchester Building Society*

[10] ¶19 *Manchester Building Society*

[11] ¶26 *Manchester Building Society*

[12] ¶172 *Manchester Building Society*

[13] ¶142 *Manchester Building Society*

[14] ¶150 *Manchester Building Society*

[15] ¶142 *Manchester Building Society*

[16] Teare J thought it just and equitable to order such reduction should, contrary to his conclusion, damages in this respect be awarded.

[17] ¶6 *Manchester Building Society*

[18] ¶17 *Manchester Building Society*