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Commentary: Manchester Building Society v Grant Thornton LLP

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On 18 June 2021, the Supreme Court handed down judgment in *Manchester Building Society v Grant Thornton LLP*.

The decision is of considerable significance to the professional services sector because of the guidance provided concerning the application of the SAAMCO (South Australia Asset Management Corp v York Montague Ltd [1997] A.C. 191, [1996] 6 WLUK 227) principle and the extent of a professional defendant's liability for negligent advice.

Background

The law has historically recognised the potential unjustness of rendering a defendant liable for all the factual ('but for') consequences of a breach of duty. The SAAMCO principle arose against this backdrop and as a mechanism for achieving an equitable outcome by limiting liability.

In practical terms, the SAAMCO principle introduced a distinction between (a) the provision of information based upon which someone else will decide upon a course of action (characterised as an 'information' case), and (b) advice as to whether a course of action is appropriate (characterised as an 'advice' case).

In the case of the former, as per Lord Hoffman's well-known mountaineer analogy ([1997] AC at 213D-F), the principle provides that the liability of a professional adviser is confined to the direct consequences of the information being wrong, whereas in relation to the latter, liability extends to all adverse consequences as a result of the course of action.

The SAAMCO principle was the subject of comparatively recent consideration by the Supreme Court in BPE Solicitors v Hughes-Holland [2017] UKSC 21. In summary, the SAAMCO principle was upheld in BPE, albeit the Supreme Court (with Lord Sumption giving the lead judgment) expressed concern regarding what he described as the "*descriptive inadequacy*" of the 'information' and 'advice' labels and that the principle had been misunderstood and misapplied in a number of preceding cases.

It was against this background that the issue returned to the Supreme Court.

Summary of the facts

The Claimant, Manchester Building Society was a small mutual building society, whilst the Defendant, Grant Thornton LLP, was a well-known firm of accounts which audited the Claimant's accounts.

Between 2004 and 2009, Manchester Building Society embarked upon a programme of fixed interest lifetime mortgages (commonly known as equity release loans). Manchester Building Society' lending was funded through variable rate borrowing, which created a risk that, if interest rates increased, the cost of funding the mortgages would exceed Manchester Building Society' return. To mitigate this risk, between 2006 and 2012, Manchester Building Society entered interest rates swaps which were diametrically opposed to the underlying mortgages: Manchester Building Society paid interest at a fixed rate, whilst the swap counterparty paid interest at a variable rate. Accordingly, if interest rates increased and Manchester Building Society' position worsened in relation to its book of lifetime mortgages, the risk would be hedged by its gains in relation to the interest rate swaps and vice versa.

However, Manchester Building Society' intended business model faced a potential difficulty as a result of changes in the accounting rules in 2005. From 2005 onwards it was necessary for Manchester Building Society to include the value of swaps on its balance sheet at fair value. This created a potential problem for Manchester Building Society in terms of volatility in its reported financial position and, by virtue of the nature of its business and the applicable regulatory regime, the level of regulatory capital which it was required to maintain.

In April 2006, Grant Thornton LLP advised Manchester Building Society that it could apply hedge accounting. This provided a potential solution and meant, if permissible, that Manchester Building Society could make corresponding adjustments to the value of the hedged items (the lifetime mortgages) in its accounts to offset the change in fair value of the swaps; thereby reducing profit volatility. Manchester Building Society duly applied hedge accounting when preparing its accounts between 2006 and 2011, which were audited and approved by Grant Thornton LLP, as well as embarking upon the previously contemplated programme of interest rate swaps.

In March 2013, it transpired that hedge accounting was not, in fact, applicable. The consequent changes to Manchester Building Society' financial position meant that it had insufficient regulatory capital and had to close out the swaps early. Following the 2007-2008 financial crisis, variable interest rates had fallen to low levels and the swaps were heavily 'out of the money' at the time. This resulted in Manchester Building Society incurring a liability of £32.7m, along with transaction costs of c£300,000.

The approach at first instance and in the Court of Appeal

Negligence was admitted by Grant Thornton LLP, hence the central issue at all levels was whether Manchester Building Society' loss fell within the scope of Grant Thornton LLP's duty and was thus recoverable.

The first instance decision of Mr Justice Teare ([2018] EWHC 963 (Comm): [2018] PNLR 27) is well reasoned, with Mr Justice Teare recognising that, on the facts of the case, cogent arguments could be made for both parties. Mr Justice Teare also acknowledged that he had not found the question of assumption of responsibility easy. However, whilst presciently avoiding the adoption of the 'information' and 'advice' labels and instead preferring the phraseology of 'assumed responsibility'; Mr Justice Teare decided that the case fell on the side of being an 'information' case and found that Grant Thornton LLP had not assumed responsibility for the swaps being out of the money following a sustained fall in interest rates; rather, Manchester Building Society' loss flowed from market forces.

The Court of Appeal reached the same conclusion, albeit preferring to adopt a more rigid application of the SAAMCO principles and terminology and finding in clear terms that this was an 'information' case. It is clear from the lead judgment of Lord Justice Hamblen that an influential factor in finding that Manchester Building Society' loss was not a reasonably foreseeable consequence of Grant Thornton LLP's information being wrong was that the swaps were closed out at fair value and receiving fair value for an asset does not ordinarily give rise to a loss. Further, Manchester Building Society could not show that the same loss would not have been incurred had the swaps been held to term and that loss had been caused by early closure.

The Supreme Court's decision

The Supreme Court unanimously upheld the appeal and found that Manchester Building Society' losses were within the scope of Grant Thornton LLP's duty.

However, it is notable that there was not unanimity of approach between the constitution of seven Justices (although the decision was unanimous). In this regard, a majority judgment was provided by Lord Hodge and Lord Sales (with the agreement of Lord Reed, Lady Black and Lord Kitchen), with discrete judgments provided by Lords Leggatt and Burrows.

The majority held that in negligence cases a series of six questions arise:

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) (Paragraph 6)

The scope of duty question was the central issue for the purposes of the appeal, with the reasoning of the majority in relation to matters of principle being as follows:

- The scope of the duty of care assumed by a professional adviser is governed by the purpose of the duty, to be judged on an objective basis by reference to the reason why the advice is being given.
- It is appropriate to look at the risk the duty was supposed to guard against and ask whether the loss suffered represented the fruition of that risk.
- The 'advice' and information' labels are unhelpful. They may be apt for cases at either end of the spectrum of involvement and responsibility for decision-making but between lies considerable middle-ground where it is inappropriate to try and 'shoe-horn' cases into two inflexible categories.
- The SAAMCO counterfactual (in an information case, asking whether the loss have been suffered in any event had the information provided been correct) should be used as no more than a cross-check but should not form part of the court's primary analysis.

On the facts of the case, Grant Thornton LLP understood the issue faced by Manchester Building Society regarding regulatory capital and the associated significance of hedge accounting in reducing profit volatility. Manchester Building Society had looked to Grant Thornton LLP for technical accounting advice as to whether it could use hedge accounting in order to implement its proposed business model within the relevant regulatory constraints. Grant Thornton LLP advised that it could. Accordingly, the loss suffered by Manchester Building Society loss represented a fruition of the risk (profit volatility and a requirement for increased regulatory capital as a result) which Grant Thornton LLP's duty was intended to guard against.

The reasoning of Lord Burrows is similar to the majority, save that focus was placed upon an effective hedging relationship; specifically, the fact that Grant Thornton LLP had negligently mispresented to Manchester Building Society that an effective hedging relationship existed between the swaps and the lifetime mortgages. Lord Burrows also expressed concern regarding the novel (and, as yet, untested) 'duty nexus' terminology.

The lack of an effective hedging relationship was also central to the reasoning of Lord Leggatt. However, Lord Leggatt placed greater emphasis on the need for a causal connection between the matters which made Grant Thornton LLP's advice incorrect and Manchester Building Society' basic loss. Applied to the facts, Lord Leggatt found that Manchester Building Society' loss was caused by the lack of an effective hedging relationship between the swaps and lifetime mortgages, and it was Grant Thornton LLP's failure to appreciate and report this fact to Manchester Building Society which made its advice wrong.

However, in contrast to the majority, Lord Leggatt rejected the idea that the purpose of Grant Thornton LLP's duty was to avoid or mitigate profit volatility and adverse regulatory capital consequences and that these were risks which Grant Thornton LLP owed a duty of care to protect Manchester Building Society against.

Conclusion

The Supreme Court's decision is undoubtedly significant. However, it is important to appreciate that this does not impact the existence of the SAAMCO principle, and this remains a fundamental tenet of the tort of negligence in relation to claims against valuers and other professionals. Rather, the recent development of the law goes only to the method of its application.

It remains to be seen whether the guidance provided by the Supreme Court, including the six questions suggested by the majority, leads to greater clarity and consistency within the lower courts. However, what can be said with certainty is that the approach which has been advocated by the Supreme Court is more nuanced and flexible in nature.

We anticipate that the decision is not going to drastically impact every professional negligence claim. Rather, its principal relevance lies in relation to those cases which do not fall neatly within either of the historic 'information' and 'advice' categories (as per the facts in this case).

The question of how auditors and other professional advisers might look to protect themselves in light of the decision is an important one.

It seems to us that two main themes emerge.

Firstly, a logical starting point is the terms of the retainer. We suggest that it would prudent to agree and clearly document the purpose of the retainer and the risks which it is intended to guard against. However, this is does not provide a 'watertight' solution. Accordingly, we suggest that liability limits should also be reviewed and considered.

The second theme concerns knowledge.

It follows from the Supreme Court's decision that the less that an adviser knows regarding the commercial context of its advice and the operation of a client's business, the better the prospects are of limiting liability in the event of negligent advice.

However, a policy of consciously avoiding knowledge runs contrary to convention and is likely to present practical difficulties in terms of service delivery.

Accordingly, we suggest that professional service providers should ensure that they understand the different types of work which are being undertaken for each client, along with the reasons for such, in order to understand the potential liability implications and to make informed decisions; including with regards to the acceptance of instructions.

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