Scope of duty in professional negligence: the return of "advice" versus "information"

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The *Manchester Building Society v Grant Thornton UK LLP* decision

1. In Manchester Building Society v Grant Thornton UK LLP [2019] EWCA Civ 40 an auditor gave incorrect information to a building society concerning the accounting treatment of long-term interest rate swaps. When that information was discovered to be wrong, and the building society consequently had to close out the swaps, the auditor was not liable for the market losses sustained as a result.

2. This recent Court of Appeal decision primarily deals with the reformulated approach to scope of duty set out in BPE Solicitors v. Hughes-Holland [2017] UKSC 21. In this case, the Court seems to favour a return to the well-known classification between "advice" or "information" cases.

3. The trial judge had interpreted BPE Solicitors as moving away from that classification. Instead, he thought, one had to ask whether the defendant had assumed responsibility for the particular loss. The Court of Appeal agreed with his ultimate conclusion, but not with his approach of "*asking an open-ended question as to the extent of assumption of responsibility*". That was unnecessary because the traditional classification *already involves* a decision as to assumption of responsibility (at [58]-[59]).

3PB's Analysis

4. **The facts.** Between 2004 and 2009 Manchester Building Society (**"MBS"**) issued a number of fixed-interest lifetime mortgages. MBS needed to hedge its interest rate risk (the risk that the variable rate of interest which it paid to acquire funds would exceed the fixed rate which it would receive from borrowers). MBS hedged this risk by purchasing interest rate swaps between 2006 and 2011.

5. Those swaps had to be reported in its accounts at fair value. MBS had a particular concern that that would mean that its balance sheet would be liable to fluctuations, reflecting the market value of the swaps, which it needed to avoid. In April 2006 Grant Thornton (**"GT"**) advised MBS that it could apply a particular accounting treatment in order to mitigate that volatility. In accordance with GT's advice, MBS prepared its financial statements using 'hedge accounting' for the years ending 31 December 2006 to 2011. GT audited MBS's financial statements for these years and signed an unqualified audit opinion each year.

6. In March 2013 GT informed MBS that hedge accounting may not be applicable. In addition, the variable rate of interest had dropped since the financial crisis of 2008, leading the market to forecast that the variable rates would be less on average than the fixed rates payable by MBS over the unexpired period of the swap.

7. In June 2013 MBS closed out the swaps because of the volatility to which its balance sheet was exposed. MBS incurred substantial mark-to-market (**"MTM"**) losses (of about £48.5M) and transaction costs, for breaking the swaps early. GT was properly responsible for the transaction costs, so it was only the MTM losses that were in issue in the appeal.

8. Negligence was admitted. MBS's position in relation to loss was that, had GT advised that hedge accounting could not be applied, MBS would not have taken out any more long-term swaps from April 2006 and would have broken the swaps it held at that point.

9. **The decision at first instance.** At first instance Teare J. found that the MTM losses were not recoverable. Although GT's negligence was one of the effective causes of the loss suffered in

2013 (because hedge accounting was supposed to mitigate the effects of volatility of the swaps and it was such volatility which led to the closure of the swaps), it was not a loss within the scope of GT's duty of care. In other words, although the accounting treatment had a real effect in determining the extent to which the volatility affected the reported profits, GT did not assume responsibility for the risk that there would be a sustained fall in interest rates. The decision whether or not to use interest rate swaps as a hedge was a commercial decision. The loss flowed from market forces rather than the actions of GT.

10. **The issues on appeal.** One of the main issues in the appeal was whether the Judge had erred in law when asking whether GT had assumed responsibility for the MTM losses, rather than by considering whether this was an "advice" or "information" case (as originally explained by Lord Hoffmann in the SAAMCO case[1]). In adopting that approach the Judge had noted Lord Sumption's reference to the "*descriptive inadequacy of these labels*" in BPE Solicitors.

11. A second important issue was whether, if this was an 'information' case, the Judge had correctly approached the 'SAAMCO cap'. The SAAMCO cap involves consideration of what the client's position would have been had the information been correct. Any losses that he would still have suffered are irrecoverable.

12. **The Court of Appeal's decision.** The Court of Appeal's decision was essentially that:

    12.1. in cases based on negligent advice, the 'advice'/'information' distinction was helpful and the Judge should have considered which type of case it was;

    12.2. on the facts this was an information case;

    12.3. consequently, in relation to the SAAMCO cap: (i) MBS needed to prove that if GT's advice had been correct, it would not have suffered the loss; (ii) MBS had failed to prove what the position would have been if GT's advice had been correct, so it could not recover the MTM losses.

13. **The "advice" and "information" distinction.** The Court of Appeal reiterated that the SAAMCO principle, which concerns scope of duty, is additional and distinct from the filters of effective causation and remoteness. A claimant must satisfy all three in relation to a loss that he claims (at [50]).

14. Rather than asking whether the losses were within the scope of the retainer (*i.e.* the approach suggested in BPE Solicitors), the 'advice'/'information' distinction "*clearly*" applied here because it was a case where it was alleged that, in reliance on negligent advice, the claimant had suffered loss from entering into a transaction (at [55]). Further, in that context 'advice' has a specific meaning. It means, essentially, advice in "*guiding the whole decision making process*". If a professional has provided such "advice", it would be liable for all of the foreseeable losses flowing from its client having entered into the transaction.

15. At paragraph 54 of the judgment the Court of Appeal helpful set out 6 steps to be taken when applying the SAAMCO principle:

    (1) It is first necessary to consider whether it is an "advice" case or an "information" case. This is a necessary first step because the scope of the duty, and therefore the measure of liability, is different in the two cases.

    (2) It will be an "advice" case if it can be shown that it has been "left to the adviser to consider what matters should be taken into account in deciding whether to enter into the transaction", that "his duty is to consider all relevant matters and not only specific matters in the decision" and that he is "responsible for guiding the whole decision making process".

    (3) If it is an "advice" case, then the negligent adviser will have assumed responsibility for the decision to enter the transaction and will be responsible for all the foreseeable financial consequences of entering into the transaction.

    (4) If it is not an "advice" case, then it is an "information" case and responsibility will not

[1] South Australia Asset Management Corpn v. York Montague Ltd [1997] 1 AC 191 (HL), at p.214.

have been assumed for the decision to enter the transaction.

(5) If it is an "information" case, the negligent adviser/information provider will only be responsible for the foreseeable financial consequences of the advice and/or information being wrong.

(6) This involves a consideration of what losses would have been suffered if the advice and/or information had been correct. It is only losses which would not have been suffered in such circumstances that are recoverable.

16. Using the 6-stage test, the Court of Appeal found that this was not an "advice" case; GT gave accounting advice, but it was not advice involved in the *decision to enter* the swaps (at [63]), as opposed to how those should be recorded in its financial statements. It was stated that what is important is the *purpose and effect* of the advice given.[2] The advice did not "*guide the whole decision making process*" because MBS had taken into account other important, commercial considerations to which GT had not been a party.

17. **The SAAMCO cap.** As a result of the conclusion that this was an "information" case, MBS needed to prove that the MTM losses would have been avoided if GT's advice had been correct. In previous cases this has been described as a tool for assessing whether the claimed loss results from the factor that makes the defendant's conduct wrongful, *i.e.* the inaccuracy of its information.

18. MBS, however, had to do more than establish the fact of the MTM losses, it had to prove the counter-factual that the loss would not have been suffered had it continued to hold the swaps. The MTM value was the best available evidence of the fair value of the swaps and by closing the swaps, MBS incurred a liability to pay their negative MTM value, but it also obtained the (equal) benefit of removing a liability from its balance sheet. The loss claimed looks to the future, so the relevant counter-factual must as well.

19. The Court of Appeal stated, at paragraph 89 that, if MBS could show that it had it not been compelled to close the swaps out in 2013 it would have closed them out at a later and more advantageous time, it would be an example of a loss caused by the need to close the swaps in 2013, but that was not how MBS's case was pleaded. It seems that this would have been difficult in any event given the inherent unpredictability and volatility of such markets.

20. The Court of Appeal therefore found that the Judge at first instance was wrong to find that MBS had established that the MTM losses would not have been incurred had the information or advice been correct, but on the Judge's own findings, this had not been proven (see paragraph 96). Therefore the Judge at first instance reached the correct overall conclusion in relation to the non-recoverability of the MTM losses (although by different means) and so the appeal was dismissed.

Impact of the Decision

21. After a seed of doubt planted by Lord Sumption in BPE Solicitors, this decision restores the orthodoxy that the 'advice'/'information' distinction continues to apply in cases where a claimant asserts that, in reliance on negligent advice, he suffered loss by entering into a transaction. It is unnecessary to ask (as the Judge had done) an open-ended question as to the extent of the responsibility assumed by the defendant, because this distinction already *involves* an evaluation on that point.

22. The terms "advice" and "information" can be helpful if used in the correct way. Misunderstandings can be avoided if proper consideration is given to the guidance in SAAMCO, BPE Solicitors and this case.

23. My concern is that the labels may cloud the underlying assessment that is required to be undertaken, and the 3 terms used in stage 2 of the 6-stage test set out above (whether it was

[2] But it is important to recall that the fact that the information supplied by the defendant is critical to the client's decision to enter the transaction, does not automatically give rise to an "advice" situation: see BPE Solicitors, at [42].

"*left to the adviser to consider what matters should be taken into account in deciding whether to enter into the transaction*", that "*his duty is to consider all relevant matters and not only specific matters in the decision*" and that he is "*responsible for guiding the whole decision making process*") may simply be different assessments of the extent of the responsibility that the professional assumed. Therefore, considering assumption of responsibility for a particular loss, which is a familiar technique in other legal contexts, may be more specific and a more direct analytical tool to link recoverable losses with the extent of the defendant's duty.

24. The "advice" or "information" distinction may, however, help in determining when and how to apply the SAAMCO cap, once it is decided that the case falls within the information category.

25. Whatever test is applied, legal advisers will bear in mind that recent authority demonstrates that it is rare for professionals to "*guide the whole decision making process*" when a client is entering a commercial transaction.

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