Informing Progress - Shaping the Future

FOIL UPDATE 21 June 2021

The scope of the duty of care in the context of professional advice

Manchester Building Society v Grant Thornton UK LLP (2021) UKSC 20

IN BRIEF

The Supreme Court unanimously allowed the claimant's appeal. It held that the claimant suffered a loss falling within the scope of the duty of care assumed by the defendant, having regard to the purpose for which it gave its advice on the use of hedge accounting

It analysed in detail a six-part test to be applied.

This appeal concerned the approach to ascertaining the scope of a defendant's duty of care laid down in *South Australia Asset Management Corpn v York Montague Ltd [1997] AC 191 ("SAAMCO"),* in the context of professional advice given by accountants. It was one of two appeals heard by the same panel of seven justices, examining the application of *SAAMCO* in different fields. It was handed down and should be read together with the court's judgment in *Khan v Meadows,* which is the subject of a further FOIL Update.

The claimant/appellant (the society) is a small mutual building society. Until 2012, the society's accounts were audited by the respondent, the defendant/respondent, a firm of accountants. In 2006 and annually thereafter, the defendant incorrectly and negligently advised the society that its accounts could be prepared according to a method known as "hedge accounting" and that accounts prepared using that method gave a true and fair view of the society's financial position. In reliance on that advice, the society carried on a strategy of entering into long-term interest rate swaps as a hedge against the cost of borrowing money to fund its lifetime mortgages business. The misstated accounts served to hide 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 mortgages which the swaps were supposed to hedge. When, in 2013, the defendant realised its error, the society had to restate its accounts, showing substantially reduced assets and insufficient regulatory capital. To remedy the situation, the society closed out the interest rate swap contracts early at a cost of over £32m.

The issue on this appeal was whether the society could recover in damages the cost of closing out the swaps from the defendant. The trial judge and the Court of Appeal held it could not, in each case based on their understanding of the scope of duty principle illustrated in *SAAMCO*.

The Supreme Court unanimously allowed the appeal. It held that the society suffered a loss falling within the scope of the duty of care assumed by the defendant, having regard to the purpose for which it gave its advice on the use of hedge accounting. The defendant was liable for the loss suffered by the society in breaking the swaps early, subject to a reduction in damages of 50% for contributory negligence.

The scope of duty principle was that a defendant was liable only for losses which fell within the scope of his or her duty of care to the claimant. It was helpful to analyse the place of the scope of duty principle within a general conceptual framework of the law of the tort of negligence, set out in *Khan v Meadows* and reproduced here.

(1) Was the harm (loss, injury and damage) which was the subject matter of the claim actionable in negligence? (The actionability question);

(2) What were the risks of harm to the claimant against which the law imposed 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) Was the loss for which the claimant sought damages the consequence of the defendant's act or omission? (The factual causation question);

(5) Was there a sufficient nexus between a particular element of the harm for which the claimant sought damages and the subject matter of the defendant's duty of care as analysed at stage 2 above? (The duty nexus question); and

(6) Was a particular element of the harm for which the claimant sought damages irrecoverable because it was too remote, or because there was a different effective cause or because the claimant had mitigated his or her loss or had failed to avoid loss which he or she could reasonably have been expected to avoid? (The legal responsibility question).

The scope of the duty of care assumed by a professional adviser was governed by the purpose of the duty, judged on an objective basis by reference to the reason why the advice was being given. One looked to see what risk the duty was supposed to guard against and then looked to see whether the loss suffered represented the fruition of that risk. The distinction drawn between "advice" and "information" in *SAAMCO* should not be treated as a rigid rule and the focus should rather be on identifying the purpose to be served by the duty of care assumed by the defendant. Related to this, the *SAAMCO* counterfactual, which asked whether in an "information" case the claimant's actions would have resulted in the same loss if the advice given by the defendant had been correct, was simply a tool to cross-check the result given pursuant to an analysis of the purpose of the duty. It was subordinate to that analysis and should not supplant or subsume it.

In the present appeal, the purpose of the defendant’s advice was to establish whether the society could use hedge accounting within the constraints of the applicable regulatory environment to implement its proposed lifetime mortgages business model. It negligently advised that it could. As a result, the society entered into swap transactions pursuant to the business model and was exposed to the risk of loss in breaking the swaps when it was realised that hedge accounting could not in fact be used, exposing the society to regulatory capital demands which the use of hedge accounting was supposed to avoid. That was a risk that the defendant’s advice was supposed to allow the society to assess, and which its negligence caused the society to fail to understand.

The loss suffered by the society therefore fell within the scope of the duty of care assumed by the defendant, in light of the purpose of its advice. It followed that the defendant was liable for the loss suffered by the society in breaking the swaps once the true accounting position was appreciated, reduced by 50% on account of the society’s contributory negligence.