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Legal filters, "advice or information" and auditors' liability: *Manchester Building Society v Grant Thornton UK LLP* [2019] P.N.L.R. 12

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Introduction

Manchester Building Society concerned an auditor's liability for losses incurred on interest rate swaps entered into in reliance on negligent accounting advice and which were closed out at a loss when the society became aware of the negligent advice. The issue for the Court of Appeal was whether the correct approach was to identify an assumption of responsibility as the trigger for liability or to identify whether the defendant had provided advice, so that it was liable for all the foreseeable consequences of the claimant entering into the swaps in reliance on that advice or had provided information so that it was liable because the losses would not have been incurred if the advice had been correct.

Factual background

Between 2004 and 2009 the claimant, Manchester Building Society (MBS), issued a number of fixed interest lifetime "equity release" mortgages over UK and Spanish homes designed to release equity to the homeowner on terms that the loan and interest were not repayable until the owner either went into a care home or died, during which time interest compounded. MBS hedged its interest rate risk (the risk that the variable rate it paid to acquire funds exceeded the fixed rate from the equity release mortgages) by purchasing interest rate swaps. After 2005 the International Financial Reporting Standards required that the swaps were included in MBS's accounts at "fair value", which meant that its financial position would be at the mercy of movement in the fair value of the swaps. However, Grant Thornton (GT), which audited MBS's accounts, negligently advised that MBS could apply an accounting treatment ("hedge accounting"), which partially offset the changes in the fair value of the swap. When the negligent advice was discovered in 2013 MBS had to amend its accounting position and as a result the revised fair value reflected the market view that MBS would be a net payer under the swaps because the post-financial crisis variable rate was forecast to be much lower than the fixed rate. MBS decided to close out the swaps and incurred losses of £32m.

MBS sued GT for its negligent failure to advise that MBS could not apply hedge accounting on the basis that, but for that negligent advice, it would not have entered into further swaps after 2006. GT admitted that any reasonably competent auditor would have concluded that MBS's financial position was materially misstated by applying hedge accounting but denied liability for the loss. The first instance judge noted that the defence raised four issues: (i) whether the negligence was a cause in fact of the loss; (ii) whether it was a cause in law; (iii) whether it was within the scope of the duty of care; and (iv) whether the loss was too remote.

The law

In *Hughes-Holland v BPE Solicitors* [2018] A.C. 599, the original claimant had assumed that his £200k loan would be used to finance a property development when, in fact, it was used to purchase the land on which the development would take place. His solicitor failed to correct that misunderstanding in a facility letter he was instructed to draw up and the claimant lost his money in a development that was unviable even if his investment had been used for that purpose. But for the solicitor's negligence the client would not have made the investment but his loss arose from risks that it was not a part of the adviser's duty to protect him against. By way of introduction, Lord Sumption said that the legal filters such as causation, mitigation and remoteness—which limited the scope of a defendant's duty—depended on a developed judicial instinct about the nature or extent of the duty that the wrongdoer had broken, [20]. He said that the essential distinction set out in *SAAMCO (Banque Bruxelles Lambert SA v Eagle Start Insurance Co Ltd* [1995] 2 All E.R. 769) is between the assessment of the loss caused by the breach of duty and the extent of the defendant's duty to protect the claimant against it. Breach of a duty to provide information to enable someone else to decide on a course of action carries liability only to the extent that the information was wrong. Breach of a duty to advise on a course of action attracts liability for the foreseeable loss caused by that course of action. At [39] Lord Sumption said that the distinction between advice and information had given rise to confusion largely because of the descriptive inadequacy of the labels since "neither label really corresponds to the contents of the bottle". Information given by a professional person to their client is usually a specific form of advice and most advice will involve conveying information. Where the adviser was responsible for guiding the whole decision-making process, their liability extends to the decision, whereas an adviser who contributes material, but where the client has made the decision, will only be liable for the financial consequences of the information being wrong [40]–[41].

Lord Sumption concluded at [55] that the solicitor was not legally responsible for the original claimant's decision to lend the money but only for confirming his assumption about one of a number of factors in his assessment of the project. Even if that assumption had been right, he would still have lost his money so none of the loss that he suffered was within the scope of the solicitor's duty.

First instance ([2018] P.N.L.R. 27, Teare J)

The judge found that: (i) but for GT's negligence MBS would not have entered into the further swaps; that (ii) the negligence was an effective cause; and that (iii) the loss was not too remote. The judge refused to decide whether GT had provided advice or information but instead analysed whether the loss was within the scope of GT's duty in accordance with the assumption of responsibility principles outlined in *Hughes-Holland*. He balanced the cogency of the parties' cases; GT had assumed responsibility because the loss flowed from the particular feature of its conduct, which made the advice wrongful, namely that hedge accounting could be applied to the swaps, or GT had not assumed responsibility because the decision to purchase the swaps was taken for commercial reasons on which GT gave no advice. He concluded at [179] that GT had not assumed responsibility for the loss that had occurred because of a sustained fall in interest rates even though the decision to close the swaps out was taken because GT had given negligent advice. MBS appealed on the ground that the judge should have found that GT had provided advice and was liable for all the reasonably foreseeable consequences of that advice being wrong.

Court of Appeal

Hamblen LJ, with whom Males LJ and Dame Elizabeth Gloster agreed, said at [54] that where it was left to an adviser to consider what matters should be taken into account in deciding whether to enter into the transaction and the adviser was responsible for guiding the whole decision-making process (an "advice" case) the adviser will have assumed responsibility for the decision to enter into the transaction and be responsible for the consequences of the transaction. In an "information" case responsibility is not assumed for the decision to enter into the transaction and the provider is liable only for the consequences of the information being wrong with the recoverable losses being only those that would not have been suffered if the information had been correct.

Hamblen LJ noted that, while the judge had been asked by both parties to decide the case using the advice/information approach, he had not done so because of the "descriptive inadequacy of the labels" (per Lord Sumption in *Hughes-Holland* at [39]). However, he had been wrong to do so because that did not undermine the "clear and important distinction" between the labels that the court must determine rather than asking an "open-ended question as to the extent of the assumption of responsibility", [58]. By definition in an advice case the defendant will have assumed responsibility for the decision to enter into the transaction ("guiding the whole decision-making process") whereas in an information case the defendant has only assumed responsibility for the consequences of the information being wrong. The judge had found that MBS's decision to enter into the swaps was taken on the basis of GT's advice but also commercial considerations on which GT had given no advice; on that basis it was an "information" case.

The court then considered MBS's alternative argument that, if it was an information case, it was entitled to recover losses that would not have been incurred if GT's accountancy "information/advice" had been correct. The judge had found that, if the information had been correct, MBS would not have broken the swaps and incurred the loss; MBS argued that because of GT's negligence, the swaps were closed out. Hamblen LJ noted that a striking feature of the case was that the damages claim consisted of the fair value of the swaps that would not ordinarily give rise to loss. As the argument was based on having to close out the swaps he considered the "counter factual", namely continuing to hold them to term; the best evidence would still be the fair value at that time. At [88] he said that, in order for MBS to prove that it would not have suffered the losses if GT's advice had been correct, it had to prove the counter factual, which was that the loss would not have been incurred if it had continued to hold the swaps that it could not do since the fair value would still have reflected the adverse movement of interest rates.

As GT, in an information case, had not assumed responsibility for the swap transaction but only for the financial consequences of the information being wrong, MBS had not proved that its losses would not have occurred if that advice had been correct. The judge had been correct to dismiss the claim and to observe that it would be a striking conclusion that an accountant who gave advice on how business activities might be treated in its accounts had assumed responsibility for the financial consequences of those business activities, [99].

Postscript

The case turned on its particular facts in relation to proof of loss based on the future valuation of swaps. However, the application of the *Hughes-Holland* guidelines will alert advisers to the need to draft terms and conditions that express provide that they are not guiding the whole decision-making process and that the decision to enter into a transaction is made by the client alone.