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Supreme Court Clarifies Approach to Determining the Scope of the Duty of Care Owed by Professional Advisers

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In the highly anticipated decision in *Manchester Mutual Building Society v Grant Thornton UK LLP* [2021] UKSC 20, the Supreme Court has unanimously allowed an appeal by the claimant, a mutual building society, and held that certain losses suffered by it fell within the scope of the duty of care assumed to it by the defendant, the claimant's auditor, and were therefore recoverable as damages in a claim for professional negligence.

The significance of the decision lies in the Supreme Court's guidance on the proper approach to determining the scope of the duty of care owed by professional advisers to their clients in tort, including the application of the so-called "**SAAMCO Principle**" first adopted in *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191 ("**SAAMCO**"). The majority of the Supreme Court held that the scope of the duty of care assumed by a professional adviser is governed by the purpose of the duty, which is judged on an objective basis by reference to the purpose for which the advice is given. This essentially means that in order to determine the scope of the professional adviser's duty, you must consider the risk the duty was supposed to guard against and then assess whether the claimant's loss was the result of that risk coming to pass.

The majority also considered that the distinction first drawn in SAAMCO between situations where the professional adviser was giving "advice" and situations where the adviser was merely contributing "information" was not particularly illuminating and should be disregarded.

The progress of this case through the courts has been closely watched by all professional advisers, and the impact of the Supreme Court ruling will be significant in claims brought against such advisers for economic loss due to negligent advice. One of the key practical takeaways from the decision is to ensure, at the outset of any engagement, that there is an agreement between the relevant adviser and its client as to the purpose for which the advice is being given and how it will be used by the client, because it is the purpose of the advice that will ultimately govern the scope of the adviser's duty in tort. Accordingly, it is likely that the engagement documentation will be a fundamental factor in determining the scope of the duty.

The SAAMCO decision

At the outset, it is useful to re-visit the principles laid down by the House of Lords (as it then was) in SAAMCO and the subsequent difficulties that the lower courts have faced in applying the SAAMCO Principle in differing factual scenarios.

The SAAMCO litigation arose out of the negligent over-valuation of a number of properties that were given to the claimant lender as security for certain loans. The lender had relied on the valuations in

deciding whether, and how much, to lend on the security, and ultimately suffered losses when the borrower defaulted and the property was sold. This took place against the backdrop of a substantial fall in property prices in the early 1990s. The question for the courts was whether the lender could recover its loss in full, or whether the damages should be limited in some way to reflect the fact that the losses suffered were partly due to the wider fall in property prices.

The House of Lords concluded that the damages recoverable by the lenders were limited to the amount by which the security was overvalued, as opposed to the full depletion in value caused by the overvaluation and the fall in property prices acting together. Lord Hoffman, with whom the other justices agreed, started from the general principle that a person who owes a duty of care to another is not normally liable for all the consequences of a breach of that duty, but only for losses of the kind that fall within the scope of the duty that was owed. This became known as the SAAMCO Principle, whereby the law does not *"make the wrongdoer liable for all the consequences of his wrongful conduct [but] limits liability to those consequences which are attributable to that which made the act wrongful."*

In applying this general principle, Lord Hoffman drew a distinction between a *"duty to provide information for the purpose of enabling someone else to decide upon a course of action and a duty to advise someone as to what course of action he should take"* (emphasis in the original). This has since given rise to a distinction between "advice" cases and "information" cases.

In an "advice" case, it is left to the adviser to consider what matters should be taken into account by its client when the client is deciding how to proceed. If one such matter, which later proves to be critical, has not been taken into account or has been negligently misjudged by the adviser, then the client will be entitled to recover all losses flowing from the course of action that it has taken because the adviser had a duty to protect against those losses. In contrast, where the professional adviser contributes only a limited part of the material on which the client will rely in order to decide whether to follow a course of action, the adviser's legal responsibility is limited to the consequences of that information being wrong and does not extend to all losses arising from the client's decision itself. However, these labels have proved to be difficult to apply in practice.

Another aspect of SAAMCO that has drawn attention is Lord Hoffman's use of a "counterfactual test" in "information" cases, in order to identify the loss for which a negligent provider of information is responsible, by asking: would the loss have occurred even if the information provided by the defendant had been correct? Put another way, this counterfactual test requires a consideration of whether, but for the alleged breach, losses of the type and scale suffered would have occurred. The House of Lords considered that the application of a counterfactual test in "information" cases revealed the level of loss that was attributable to the breach of duty and therefore determined the limit that should be placed on recoverable damages. This has sometimes been referred to as the "**SAAMCO Cap**". Again, the SAAMCO Cap has proven difficult to apply in practice, as the inputs that go into a counterfactual analysis can be numerous and varied, sometimes leading to surprising results.

There have been a number of high-profile cases in recent years regarding the application of the principles laid down in SAAMCO, including the Court of Appeal decision in *Assetco Plc v Grant Thornton UK LLP* [2020] EWCA Civ 1151, which we covered here. Given that these decisions often wrestled with the application of the SAAMCO Principle to a particular set of facts (and sometimes generating controversy and confusion in the process), the Supreme Court's decision in the present case was necessary in order to provide an authoritative view on the subject.

Factual Background

The defendant, Grant Thornton UK LLP ("**Grant Thornton**"), was engaged by the claimant, Manchester Mutual Building Society ("**MBS**"), to audit its accounts between 1997 and 2012.

Between 2004 and 2010, MBS purchased and issued lifetime mortgages (i.e., mortgages secured against a borrower's home that did not become repayable until the borrower died, moved home, or chose to redeem the mortgage). MBS funded the mortgage loans by borrowing at variable rates of interest. In order to protect itself against the risk that the variable cost of borrowing would exceed the fixed rate of interest receivable on the mortgage loans, MBS entered into interest rate swap contracts.

From 2005 onwards, MBS had to prepare its accounts in accordance with the International Financial Reporting Standards, which require swaps to be accounted for on the balance sheet at their fair value. The mortgage loans, on the other hand, were accounted for at their amortised cost (or book value). A consequence of accounting for the swaps at fair value was that the balance sheet would reflect movements in interest rates, which would cause the reported financial position to look volatile. The volatility would increase the amount of capital MBS needed to hold to satisfy its regulatory obligations.

However, this volatility could be mitigated if MBS was able to use "hedge accounting". Where hedge accounting is permissible, the carrying value of the hedged item (here, the lifetime mortgages) can be used to offset the changes in the fair value of the hedging instrument (here, the swaps), thus reducing the volatility. MBS therefore sought confirmation from Grant Thornton as to whether it was permissible to use "hedge accounting" in these circumstances. Grant Thornton negligently confirmed that it was, and MBS relied upon this advice to prepare its accounts for the years 2006–2011. MBS also relied on Grant Thornton's advice that the use of hedge accounting was legitimate when entering into more lifetime mortgages and swaps during the same period.

In 2013, Grant Thornton informed MBS that it was not permitted to use hedge accounting after all. The impact of this realisation was that MBS had to account for the fair value of the swaps in its 2012 accounts without any adjustment to the book value of the mortgages. MBS also had to restate its 2011 accounts, with the result that its reported profit of £6.35 million for 2011 became a loss of £11.4 million and its net assets were reduced from £38.4 million to £9.7 million.

As a result of these corrections, MBS had insufficient regulatory capital, with a deficit of £17.9 million. To resolve the situation, MBS terminated all of its interest rate swap contracts early at a cost of c. £32.7 million, plus transaction costs, and sold its book of lifetime mortgages (though at a small profit).

The proceedings

MBS claimed damages from Grant Thornton for the losses suffered as a result of relying on Grant Thornton's negligent advice. These losses were primarily the c. £32.7 million paid to close out the swaps in 2013, plus the transaction costs but minus the small profit made on the sale of the mortgage book. Grant Thornton admitted that it had been negligent, accepting that any reasonably competent accountant would not have advised that hedge accounting was appropriate in the circumstances (a major reason for this being the significant mismatch between the 50-year duration of the swaps and the much shorter expected duration of many of the mortgages).

However, Grant Thornton defended the claim on the basis that its negligence did not cause MBS the losses claimed, or that the losses were not recoverable in law because it did not owe MBS a duty to protect it from those sorts of losses.

The first instance decision

At first instance, the High Court awarded damages to MBS of £316,845, being only the transaction costs that were payable to terminate the swaps early, and rejected its claim for the far more substantial £32.7 million that it had paid to close out the swaps early.

The Court found that: (i) but for Grant Thornton's negligent advice, MBS would not have entered into any more long-term interest rate swaps and would have closed out those already entered into; (ii) the negligent advice was an effective cause of that loss; and (iii) the loss was reasonably foreseeable. However, it concluded that MBS could only recover damages for the relatively insignificant transaction costs because the application of the SAAMCO Principle dictated that Grant Thornton was only responsible for the losses that flowed from those matters for which it had *"assumed responsibility"*. In this regard, the Court held that *"looked at broadly, sensibly and in the round"* the other losses claimed by MBS (i.e., the amount paid to close out the swaps) flowed from free market forces that had led to a fall in interest rates and for which Grant Thornton did not assume responsibility because it had merely given advice as to the manner in which MBS's various transactions could be treated in its accounts.

The High Court also found that MBS had itself been negligent in two respects that contributed to its losses, and so the damages awarded should be reduced by 50% to reflect its contributory negligence.

The Court of Appeal decision

MBS appealed to the Court of Appeal against the ruling that it could not recover the amount paid to terminate the swaps (apart from the transaction costs). The Court of Appeal dismissed the appeal but held that the judge at first instance had erred in his application of the SAAMCO Principle by approaching the issue on an *"assumption of responsibility"* basis, and that he instead should have considered whether Grant Thornton gave "advice" or only "information" to MBS.

The Court concluded that this was not an "advice" case, in the sense that Grant Thornton was not responsible for guiding MBS's whole decision making process such that it could be liable for all of the foreseeable financial consequences of the decision to enter into the swaps. Instead, the Court held that this was an "information" case, such that Grant Thornton was only responsible for the foreseeable consequences of the information/advice it gave being wrong.

The Court further held that the trial judge had erred in holding that MBS had incurred losses on terminating the swaps that would not have been incurred if Grant Thornton's advice had been correct. In applying the counterfactual test, the Court found that MBS had failed to prove that it would have been better off had it continued to hold the swaps, and therefore MBS could not show that it had suffered a loss by terminating the swaps when it did.

The points of appeal to the Supreme Court

On appeal, the main question for the Supreme Court was the true nature and ambit of the SAAMCO decision and how this should apply in determining the scope of a professional adviser's duty.

Decision

The Supreme Court unanimously allowed the appeal, but the reasons given for reaching this conclusion differed between the majority (Lord Hodge and Lord Sales, with whom Lord Reed, Lady Black and Lord Kitchin agreed) and the minority (Lord Burrows and Lord Leggatt).

Analysing negligence claims and the scope of duty question

The majority considered that the most helpful way to analyse claims for damages in negligence was to ask the following series of questions:

1. Is the harm (loss, injury and damage) that 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 (e.g., novus actus interveniens) in relation to it or because the claimant has not mitigated their loss? (the legal responsibility question)

It was the second question—termed the "scope of duty question"—that formed the central point of the appeal.

Somewhat confusingly, the majority considered that the scope of duty question could be analysed at a later point in the series of questions and concurrently with the fifth question concerning the "duty nexus". That is, in some cases the scope of duty question will be relevant to the extent of losses claimed and whether they fall within the scope of duty assumed by the defendant such that it is appropriate to address it after identifying the losses on a "but for" analysis (i.e., question 4), and then deal with the "scope of duty" question and the "duty nexus" question at stage 5 together.

The scope of duty in professional negligence claims

In applying this analysis to the context of professional advisers, the majority emphasised that SAAMCO itself (and other leading authorities including *Caparo Industries plc v Dickman* [1990] 2 AC 605) confirmed that 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 given. Put another way, in order to determine a professional adviser's scope of duty one must consider what risk the duty was supposed to guard against and then assess whether the loss suffered "*represented the fruition of that risk*".

Lord Burrows departed from the majority on this analysis. Though he agreed that the scope of duty analysis must focus on the purpose of the advice provided, he considered that this was underpinned by a policy of achieving a fair and reasonable allocation of risk between the parties of the loss that occurred. Lord Leggatt also departed from the majority on this point, but for a different reason. He considered that the scope of duty principle is a principle of causation, and therefore the correct approach was to assess whether the loss claimed was caused by the particular matters that made the defendant's advice incorrect. The majority disagreed with both of these analyses, considering that the scope of duty principle is more readily understood without placing emphasis on causation or by referring back to questions of policy.

The distinction between "advice" and "information" cases

Lord Leggatt proposed to dispense with the distinction between "advice" and "information" cases as it was not fit for purpose.

The majority agreed, noting that the distinction is too rigid and seeking to shoe-horn a case into one category or the other was liable to mislead. Instead, the majority conceived that the range of cases constitutes a spectrum, with pure "advice" cases (i.e., those where the adviser assumes responsibility for all aspects of a course of action) at one end of the spectrum, and instances where the adviser has contributed only a limited part of the material that the client relies on at the other.

Accordingly, rather than trying to establish whether a case is a so-called "advice" case or an "information" case, the focus should instead be on identifying the purpose to be served by the duty of care assumed by the defendant in accordance with the "scope of duty question" identified above.

Application of a counterfactual analysis

While not to be entirely dispensed with, the majority also agreed with Lord Burrows that the use of the counterfactual analysis in "information" cases should be "reigned in" and regarded as a tool for cross-checking the legal analysis rather than a test to be applied in every case. In this regard, the majority considered it was a fundamental point of principle that the counterfactual test should not act as a replacement for undertaking a "scope of duty" analysis and, indeed, the key test involves identifying the scope of the duty of care owed by reference to its purpose.

In particular, the majority reasoned that a counterfactual test becomes more complex as the factual matrix of the case becomes more complex, providing greater scope for obscure and highly debatable arguments to be deployed about how the counterfactual world should be conceived. Accordingly, the counterfactual analysis cannot be allowed to drive the determination of the purpose for which advice has been given and the resulting scope of the duty of care that is owed.

Application to the present case

Applying the above to the circumstances in which Grant Thornton gave its advice to MBS, the majority considered it to be clear that the purpose of the advice was to provide technical accounting input as to whether MBS was entitled to use hedge accounting within the constraints of the regulatory environment in order to pursue its proposed business model. Grant Thornton's advice was supposed to allow MBS to assess the risk and its negligence meant that MBS did not understand the attendant risks of the swap transactions when it entered into them.

The majority considered that it was important to have regard to the commercial reasons why MBS sought the advice, and the fact that these reasons were appreciated by Grant Thornton. This was the foundation for its conclusion that the purpose of the advice was to deal with the issue of hedge accounting in the context of its implications for MBS's regulatory capital. The majority considered that the examination of this purpose showed that the wider loss that it suffered fell within the scope of Grant Thornton's duty of care.

Accordingly, the Supreme Court considered that MBS was entitled to recover damages of £26.7m, which represented the cost of closing out the swaps early, plus the transaction costs, minus the profits that it made on the sale of the mortgage book. However, these damages were reduced by 50% to accord with the findings of the trial judge that MBS had been contributorily negligent (a finding that was not subject to the appeal).

Comment

The so-called SAAMCO Principle, although readily understood as a legal theory, has proved difficult for practitioners and the courts alike to apply in practice. Confusion as to how exactly the scope of duty question should apply to a given set of facts has led to a number of cases in recent years, the outcomes of which have not always accorded with the general understanding of the principle. Hopefully, this decision of the Supreme Court will lead to greater clarity in defining the scope of the duty of care that a professional adviser owes to their client, particularly by dispensing with the often awkward distinction between "advice" and "information" cases and significantly reducing the emphasis on the complex "counterfactual" test.

That being said, while the Supreme Court has sought to distil the scope of duty question into one that is simply determined on an objective basis by reference to the purpose for which the advice is given, it may still be uncertain how, in each particular case, the specific purpose is to be identified.

However, the Court's judgment suggests that the analysis will focus on matters such as the commercial reasons for the advice and whether there was a clear understanding between the parties as to its purpose (which may be defined in the engagement letter), but it will be interesting to see how this judgment is applied in future professional negligence cases.

There is no doubt, however, that the Supreme Court's decision is significant for accountants, lawyers, financial institutions and others who provide professional advice to clients. From a practical perspective, the "purpose of duty" question will give professionals pause for thought, and they would be well-advised to ensure that their terms of engagement are fully and properly documented, and absolutely clear on the agreed purpose of the advice (not simply the content of the advice or other deliverable) and how it will be used by the client. When transactions go wrong, professional advisers are often an obvious route of recourse to recover losses, and the scope of the duties owed by accountants when scrutinising the finances of large enterprises, and advising on tax and accounting issues, is a question that often finds itself before the courts. Accordingly, it is crucial that professional advisers understand exactly what their advice is contributing towards before it is given.

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