Responsibility for losses: liability of professional advisers

There have been a number of claims going through the English courts seeking damages in relation to losses sustained from business decisions taken before the 2008 financial crisis which resulted in losses during that period. In the recent decision of *Manchester Building Society v Grant Thornton*, the High Court considered the position of a firm of accountants that had accepted that it had a duty of care to the claimant for audit work and that it had breached that duty (*[2018] EWHC 963 (Comm)*).

The case illustrates the difficulties in assessing whether a particular loss is within the adviser's scope of duty, and many of these cases will turn entirely on their facts.

Duty of care

The claims emanating from the 2008 financial crisis have considered a number of different issues regarding the defendant's tortious liability. Many of these claims have been against banks and have referred to the well-established principles in *Hedley Byrne v Heller* as to whether they are liable for negligent misstatement in the context of the duty of care to advise fully and accurately, such as in *Property Alliance Group Limited v The Royal Bank of Scotland PLC* (*[1964] AC 465; [2018] EWCA Civ 355, see News brief "Mis-selling and LIBOR: Court of Appeal test case", www.practicallaw.com/w-013-8904*).

In these cases, the court is assessing whether the defendant had a duty of care, and if so, whether the defendant was in breach of that duty. The courts have also considered whether that type of duty of care extends to an undisclosed principal and *Playboy Club London Limited & others v Banca Nazionale del Lavoro SPA* is currently awaiting judgment of the Supreme Court on this issue (*[2016] EWCA Civ 457*).

However, in *Manchester Building Society*, the facts of which also emanated from the financial crisis, the court considered the position of a firm of accountants, Grant Thornton, which accepted that it had a duty of care to the claimant, Manchester Building Society (MBS), in respect of audit work and that it had breached that duty, but that it had not assumed responsibility for specific losses. The court did not therefore consider the principles in *Hedley Byrne* at all, but based its reasoning on the Supreme Court cases of *South Australia Asset Management Corporation v York Montague Ltd* (known as *SAAMCO*) and *Hughes-Holland v BPE Solicitors* (*[1997] AC 191; [2017] UKSC 21, www.practicallaw.com/5-641-0395*).

In *SAAMCO*, the House of Lords considered what losses could be applied for when the claimant had been provided with inaccurate information. It held that only losses that are attributable to the breach can be awarded and these losses must come within the parameters of the duty. It was therefore important to define, within the scope of the duty, the matters for which the defendant had assumed responsibility. This is a fact-sensitive exercise (*Hughes-Holland v BPE Solicitors*).

The claim

MBS acquired and issued a series of lifetime mortgages issued to UK and Spanish homeowners. Unlike traditional mortgages, lifetime mortgages are of an uncertain duration and there is no return until a future, unknown date. To protect its investment, MBS hedged its interest rate risk by buying interest rate swaps. Between February 2006 and February 2012 MBS entered into 28 interest rate swaps in respect of those lifetime mortgages.

The 2008 financial crisis led to a fall in interest rates. Grant Thornton audited the accounts of MBS from 1997 until 2012. Grant Thornton gave no advice on the interest rate swaps but did advise that the fall in interest rates and the impact on the swaps and the value of the mortgages, could be offset on MBS's balance sheet by using hedge accounting. However, in 2013, MBS learnt that hedge accounting could not be used in this way and MBS's financial position was very different to what had been previously reported resulting in a serious reduction of its net assets. MBS was forced to close out the swaps, reduce its new lending and sold its book of lifetime mortgages, resulting in significant losses.

MBS issued a claim alleging that the lifetime mortgage business and swaps entered into after April 2006 would not have been entered into but for the negligence of Grant Thornton. Grant Thornton admitted the allegation of negligent auditing. However, it also claimed that the same mortgage business would have been conducted and that it would have been hedged by swaps. This meant that the same losses would have been incurred in any event. In addition, as a matter of law, the claimed losses were not caused by Grant Thornton's negligence because the losses were not within the scope of its duty of care under the *SAAMCO* principles, and Grant Thornton had not assumed responsibility for those losses.

High Court judgment

In a lengthy, fact-specific judgment, the court held that MBS was not entitled to damages in respect of certain losses caused by Grant Thornton's negligence, despite Grant Thornton's admission of negligent advice and auditing.

The court found that the losses would not have been incurred had the information or advice been correct and the losses were not too remote. However, following *SAAMCO* and *Hughes-Holland,* the court was required to form a view as to whether Grant Thornton had assumed responsibility for the type of loss that MBS incurred in 2013 when it decided to close the swaps out, as a result of finding out that hedge accounting was not suitable.

The court accepted that there was reliance on Grant Thornton's advice by MBS and that the losses were reasonably foreseeable but this was not enough to show that Grant Thornton assumed responsibility for those losses. Looking at the matter in the round, the court concluded that the loss flowed from market forces for which Grant Thornton did not assume responsibility, notwithstanding that the decision to close out the swaps was taken because Grant Thornton's advice was wrong. The court held therefore that the losses were not recoverable as damages.

The need for a nuanced approach

Although *Manchester Building Society* considers a different aspect of the assumption of responsibility from the *Hedley Byrne* line of authority, a similar line of reasoning is followed; the Court of Appeal in *PAG v RBS,* when considering misstatement and assumption of responsibility leading to the imposition of a tortious duty held that what amounts to a misstatement in this context will depend on the facts of the relationship

and identification of the matter for which the defendant has assumed responsibility. It is, therefore, an elastic duty that is fact sensitive.

In *Manchester Building Society*, the court concluded that while Grant Thornton had assumed responsibility for the auditing of the accounts, it had not assumed responsibility for the losses sustained from the product, the swaps, that it had to audit and so was not responsible for the losses emanating from this.

It is an important distinction and one that may affect the future relationships with professional advisers and others that provide advice; consideration of an assumption of responsibility, whether towards a particular defendant or for particular losses, requires a nuanced, fact-sensitive approach.

Michael Brown is a partner, and Louise Lanzkron is a dispute resolution Knowledge & Development Lawyer, at Bird & Bird LLP.