

Consistently inconsistent? Revisiting the scope of duty of care in negligence claims

Elliot Elsey considers the implications for professional advisers following recent landmark judgments in the Supreme Court



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On 18 June 2021, the Supreme Court handed down its judgment in the appeal of the cases of *Manchester Building Society v Grant Thornton* [2021] UKSC 20 and *Khan v Meadows* [2019] EWCA Civ 152 (a medical negligence case).

In its findings for the Manchester Building Society (MBS), the majority of the court stated it intended to provide general guidance about the correct approach to determining the scope of duty and extent of liability for all professional advisers.

The appeal examined whether MBS's losses fell within the scope of Grant Thornton's (GT) duty of care in providing certain auditing and accounting advice. In its judgment, the court took the opportunity to revisit the decision in *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191 (*SAAMCO*).

BACKGROUND TO THE APPEAL

MBS is a mutual building society which purchased and issued 'lifetime' mortgage products between 2004 and 2010. Those products were based on the release of equity from a borrower's home with compounding interest charged at a fixed rate, but with neither interest nor capital repayable to MBS until the borrower either died, moved out of the property or elected to make the repayment.

In order to fund the lifetime mortgages, MBS borrowed at variable interest rates. This presented a commercial risk for MBS as the interest received when the lifetime mortgages were repaid might be less than the interest paid to fund the loans. In order to mitigate that risk, MBS entered long term swaps.

In 2006, GT incorrectly advised MBS it could prepare its accounts using 'hedge accounting' to enable MBS to reduce the market-to-market value of the swaps on MBS's balance sheet.

This was important to MBS as its regulator required it to maintain specified levels of 'regulatory capital' to evidence its liquidity and protect against adverse market movements. In broad terms, the less volatile MBS's reported position, the lower the level of regulatory capital MBS required and the more lending MBS could undertake.

The 2008 financial crisis and the sustained fall in interest rates that followed meant the value of MBS's swaps became a liability. This required MBS to provide cash collateral to its swap counterparties. MBS sought to offset those liabilities on its balance sheet by adjusting the reported value of the lifetime mortgages using the hedge accounting method.

However, in 2013, GT identified that the advice given to MBS to use the hedge accounting method was incorrect. As a consequence, MBS had to restate its accounts, reporting significantly reduced assets and insufficient regulatory capital. In order to try and mitigate its position, MBS terminated all of its swap contracts at a cost of over £32m.

At first instance the judge held that MBS could not recover its losses from GT, as the costs of early termination for the swaps did not fall within the scope of the duty principle established by *SAAMCO*. The judge found MBS's losses were instead the result of market forces outside GT's control.

MBS appealed the judgment to the Court of Appeal. While the court held it agreed with the outcome at first instance, it considered the principles in *SAAMCO* had been misapplied.

The court held this was an 'information' rather than 'advice' case such that the losses suffered by MBS were not within the scope of GT's duty of care. The court also determined MBS could not prove that it would not have suffered a loss if GT's advice had been correct. Although the appeal was dismissed, a subsequent appeal was made to the Supreme Court.

THE DECISION

The Supreme Court allowed the appeal and said that it was necessary to look at the purpose of GT's advice, namely whether MBS could use hedge accounting to operate its lifetime mortgage product in the context of its regulatory obligations. GT advised that MBS could do so, when in fact it could not.

The court held MBS had suffered a loss that was within the scope of GT's duty of care and that GT was liable for MBS's consequential losses arising from GT's incorrect advice.

A 50 per cent reduction for those losses was applied on the basis of contributory negligence due to MBS's losses also being caused by MBS's enthusiastic implementation of GT's advice, which had resulted in the lifetime mortgages and swaps being mismatched.

In reaching its judgment the court outlined a series of questions that should be addressed in all professional negligence claims:

- 1) Is the harm which is the subject matter of the claim actionable in negligence?
- 2) What are the risks of harm to the claimant against which the law imposes on the defendant a duty to take care?
- 3) Did the defendant breach their duty by their act or omission?
- 4) Is the loss for which the claimant seeks damages the consequence of the defendant's act or omission?
- 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?
- 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, or because the claimant has mitigated their loss or failed to avoid loss which they could reasonably have been expected to avoid?

THE CONSEQUENCES

The MBS decision refocuses claims based on professional advice towards: the purpose of the advice or information given by the professional; and the risk that such advice was intended to protect against.


The court also emphasised there should be increased flexibility in the application of the *SAAMCO* principles as the majority of cases do not fall exactly into the categories of 'advice' or 'information', but rather somewhere between the two.

The court also highlighted the limitations of the counterfactual established under *SAAMCO* when addressing complex hypothetical circumstances. Any counterfactual should only be used as a 'cross-check' against a particular outcome, rather than a free-standing hypothetical outcome of the claimant's position if given the correct advice.

The MBS decision underlines the following points for practitioners:



- The need for advisers to ensure that they are even more precise in detailing the scope and purpose of their duties towards their clients, as well as clarifying the matters they are (and are not) retained to advise on. Advisers will need to be very careful in order to try and limit the extent of their potential liability in any retainer/terms of engagement;
- The need for advisers to be aware of their potential exposure arising from client's commercial decisions taken as result of the advice provided; and
- Where pursuing a claim for professional negligence, there needs to be a reassessment of the increasingly tenuous use of the counterfactual as a justification for claims, with those instead being utilised as a sense check for the claim.

Much of what follows will depend on the application of the principles from the *MBS* decision, but it appears there will be a significant shift in the approach to claims against professionals and their liability. There is a real likelihood that the *MBS* decision will result in a significant increase in negligence claims against a wide range of professionals. 



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