



18 June 2021

PRESS SUMMARY

Manchester Building Society (Appellant) v Grant Thornton UK LLP (Respondent)
[2021] UKSC 20
On appeal from [2019] EWCA Civ 40

JUSTICES: Lord Reed (President), Lord Hodge (Deputy President), Lady Black, Lord Kitchin, Lord Sales, Lord Leggatt, Lord Burrows

BACKGROUND TO THE APPEAL

This appeal concerns the approach to ascertaining the scope of a defendant’s duty of care laid down in *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191 (“**SAAMCO**”), in the context of professional advice given by accountants. It is one of two appeals heard by the same panel of seven justices, examining the application of *SAAMCO* in different fields. It is being handed down and should be read together with the Court’s judgment in *Khan v Meadows* [2021] UKSC 21.

The appellant, Manchester Building Society (the “**society**”) is a small mutual building society. Until 2012, the society’s accounts were audited by the respondent, Grant Thornton UK LLP (“**Grant Thornton**”), a firm of accountants. In 2006 and annually thereafter, Grant Thornton 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, Grant Thornton 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 is whether the society can recover in damages the cost of closing out the swaps from Grant Thornton. The trial judge and the Court of Appeal held it cannot, in each case based on their understanding of the scope of duty principle illustrated in *SAAMCO*.

JUDGMENT

The Supreme Court unanimously allows the appeal. It holds that the society suffered a loss falling within the scope of the duty of care assumed by Grant Thornton, having regard to the purpose for which it gave its advice on the use of hedge accounting. Grant Thornton is liable for the loss suffered by the society in breaking the swaps early, subject to a reduction in damages of 50% for contributory negligence. Lord Hodge and Lord Sales give the lead judgment with whom Lord Reed, Lady Black and Lord Kitchin agree. Lord Burrows and Lord Leggatt each give a concurring judgment.

REASONS FOR THE JUDGMENT

The scope of duty principle is that a defendant is liable only for losses which fall within the scope of his or her duty of care to the claimant. It is helpful to analyse the place of the scope of duty principle within a general conceptual framework of the law of the tort of negligence as explained in more detail in *Khan v Meadoms* [6].

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 reason why the advice is being given [13]. One looks to see what risk the duty was supposed to guard against and then looks to see whether the loss suffered represented the fruition of that risk [17]. 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 [19]. Related to this, the *SAAMCO* counterfactual, which asks 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, is simply a tool to cross-check the result given pursuant to an analysis of the purpose of the duty. It is subordinate to that analysis and should not supplant or subsume it [23].

In the present appeal, the purpose of Grant Thornton’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. Grant Thornton 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 Grant Thornton’s advice was supposed to allow the society to assess, and which its negligence caused the society to fail to understand [34].

The loss suffered by the society therefore fell within the scope of the duty of care assumed by Grant Thornton, in light of the purpose of its advice. The trial judge was entitled to conclude both that Grant Thornton’s negligent advice was an effective cause of the loss and that the society’s mismatching of mortgages and swaps in an overly ambitious application of the business model amounted to contributory negligence. It follows that Grant Thornton is 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 [36, 39].

In his concurring judgment, Lord Leggatt frames the scope of duty principle in the language of causation. The question to be determined is whether there is a sufficient causal relationship between what made the information or advice wrong and the “basic loss” (i.e. the factually caused loss) [96, 99]. Where the *SAAMCO* counterfactual is used, care should be taken to ensure that the assumptions adopted are suitable to reflect the allocation of risk between the parties to which the test is designed to give effect. There are also cases where the counterfactual cannot readily be applied [105-106]. In this case, there was a causal connection between Grant Thornton’s negligent advice and the society’s basic loss. The loss was caused by the lack of an effective hedging relationship between the swaps and the lifetime mortgages which they were supposed to hedge, which Grant Thornton failed to appreciate and report to the society, making its advice wrong [146]. Properly applying the *SAAMCO* counterfactual, if Grant Thornton’s advice had been correct and there had been effective hedging, as Grant Thornton advised there was, the loss would not have occurred [168, 175].

Lord Burrows’ reasoning in his concurring judgment is closely aligned with that of Lord Hodge and Lord Sales including in respect of avoiding a causation explanation of the scope of duty principle, the flexible role of the *SAAMCO* counterfactual and the importance of the purpose of the duty in determining the scope of the duty of care. Lord Burrows however places greater emphasis on the scope of duty principle as underpinned by the policy of achieving a fair and reasonable allocation of the risk of the loss between the parties [179, 192]. Like Lord Leggatt, Lord Burrows views Grant Thornton’s

(incorrect) advice that there was effective hedging as critical to the conclusion that the factually caused loss fell within the scope of duty owed and the proper application of the *SAAMCO* counterfactual [206, 209-210]. Lord Burrows does not consider the conceptual framework of the law of the tort of negligence proposed by Lord Hodge and Lord Sales to be necessary or helpful in this case. He advocates what he considers to be a more conventional approach to the tort of negligence which begins with the duty of care, treats the scope of duty principle as being concerned with whether the factually caused loss is within the scope of the duty of care (avoiding Lord Hodge and Lord Sales’ “duty nexus” terminology) and sees contributory negligence as one of several possible defences [212].

References in square brackets are to paragraphs in the judgment

NOTE

This summary is provided to assist in understanding the Court’s decision. It does not form part of the reasons for the decision. The full judgment of the Court is the only authoritative document. Judgments are public documents and are available at:

<http://supremecourt.uk/decided-cases/index.html>