30 January 2019

PRESS SUMMARY

Manchester Building Society (Appellant) v Grant Thornton UK LLP (Respondent) [2019] EWCA 40 (Civ)
On appeal from [2018] EWHC 963 (Comm)

LORD/LADY JUSTICES: Lord Justice Hamblen, Lord Justice Males, Dame Elizabeth Gloster

BACKGROUND TO THE APPEAL

This appeal concerns the liability of an auditor for losses incurred on long term interest rate swap agreements which were entered into in reliance upon negligent accounting advice, and which were closed out at a loss when that negligent advice came to light.

Between 2004 and 2009, Manchester Building Society ("MBS") issued a number of fixed interest lifetime mortgages, which released equity to homeowners on terms that the loan and interest were not repayable until the owner either entered a care home or died. MBS also purchased interest rate swaps to hedge the risk that the variable rate of interest it paid to acquire funds would exceed the fixed rate which it received from borrowers.

A change in accounting rules meant that from 2005 onwards MBS was required to include the fair (mark-to-market) value of the swaps on its balance sheet. This meant that MBS's financial position, as stated in its accounts, would be at the mercy of movement in the fair value of the swaps, which would cause volatility in MBS's reported financial position.

In April 2006, MBS's auditor, Grant Thornton ("GT"), advised MBS that it could apply hedge accounting rules to the interest rate risk under the lifetime mortgages and corresponding swaps. Hedge accounting enabled adjustments to be made to the carrying-value of the mortgages to partially offset the changes in the fair value of the swap, thereby reducing accounting volatility. From April 2006, MBS relied on GT's advice on the applicability of hedge accounting when entering into further lifetime mortgages and in continuing to enter and to hold swaps.

In 2013, after six years of reliance on GT's audit advice, it became apparent that MBS was not entitled to apply hedge accounting. MBS was thereby exposed to significant volatility on its balance sheet and the decline in variable interest rates caused by the financial crisis meant that its accounts no longer disclosed sufficient regulatory capital. The decision was taken to close out the swaps, which were broken at their fair value in June 2013 with a mark-to-market loss of £32.7 million.

MBS contended that GT was responsible for the losses it incurred because these losses flowed from the need to close out the swaps following the correction of the negligent advice as to accounting treatment. According to the recent restatement of the *SAAMCO* line of authority in *Hughes-Holland v BPE Solicitors* [2017] UKSC 21,

this was an "advice" case, with the consequence that GT was liable for all the foreseeable consequences of MBS entering into the swaps in reliance on that advice. Alternatively, this was an "information" case, and GT was liable because the losses would not have been incurred if the advice regarding hedge accounting had been correct.

Teare J held that causation in fact and law was established. The losses sustained by MBS when it broke the swaps were the reasonably foreseeable consequence of GT's negligence, and were not too remote. The Judge rejected the *SAAMCO* "advice"/"information" distinction and considered that the relevant question was whether GT had assumed responsibility for the losses. The Judge held that such responsibility had not been assumed and that the loss flowed from market forces for which GT had no responsibility. Accordingly, GT was only liable for the transaction costs of £285,460 and not the £32.7 million mark-to-market loss.

JUDGMENT

The Court of Appeal unanimously dismisses the appeal.

REASONS FOR THE JUDGMENT

(i) Assumption of responsibility: the correct test?

The *SAAMCO* principle, as authoritatively explained and restated in *Hughes-Holland*, is an important legal filter which eliminates certain losses from the scope of a negligent adviser's responsibility **[49]**. As summarised at **[54]**, in an "advice" case, it will have been left to the adviser to consider what matters should be taken into account in deciding whether to enter into the transaction, and he will be responsible for guiding the whole decision-making process. In such a case the adviser will have assumed responsibility for the decision to enter the transaction and will be liable for all the foreseeable financial consequences of so doing. If it is not an "advice", as defined in *Hughes-Holland*, it will be an "information" case. In an "information" case, the adviser has not assumed responsibility for the whole transaction and will only be responsible for the foreseeable financial consequences of the information provided being wrong. Only losses which would not have been suffered had the information been correct are recoverable (see also **[46-54]**).

This was clearly a case in which the *SAAMCO* principle applied. The Judge should have considered whether this was an "advice" or "information" case **[55, 59]**. Lord Sumption's reference to the "descriptive inadequacy" (*Hughes-Holland*, at [39]) of these labels did not undermine the important distinction they articulate **[56-57]**.

(ii) An "advice" case?

This was not an "advice" case. GT gave accounting advice only; it was not involved in the decision to enter into the swaps **[63]**. Although GT did give advice to MBS, the purpose of that advice was limited: it did not determine what matters were to be taken into account in deciding whether to enter the transactions, nor did it guide the whole decision making process **[64]**. In so far as he did not do so, the Judge should have found that this was an "information" case **[74]**.

(iii) If this is an "information" case, was the Judge wrong for failing to hold GT liable for the reasonably foreseeable consequences of the information/advice being wrong?

The Judge was wrong to find that MBS had established that the mark-to-market loss would not have been incurred had the advice/information been correct. On his own findings, this had not been proven **[96]**.

MBS' claim for damages reflected the fair value of the swaps it held. Receiving fair value does not ordinarily give rise to any loss. Had the swaps been "in the money" at the time the negligent advice was discovered, the swaps would probably still have been closed out but that would not have given rise to any loss **[80-81]**. The fact that the swaps were "out of the money" should make no difference in principle; whilst MBS incurred a liability to pay their negative mark-to-market value, it also obtained the equal benefit of removing a liability from its balance sheet **[82][87].**

To prove that it would not have suffered the mark-to-market losses if GT's advice had been correct, MBS needed to prove the relevant counter-factual, namely that the loss would not have been suffered had they continued to hold the swaps **[88]**. This had not been established. MBS could not show, for example, that had they not been compelled to close out the swaps in 2013, they would have closed them out at a more advantageous time **[89]**. Indeed, by the time of trial the losses on the swaps would have been far greater than at the time they were closed out in 2013. The fact that the swaps were "out of the money" in 2013 was the result of market forces. Closing the swaps in June 2013 crystallised that loss, but did not create it **[95]**.

Accordingly, the Judge reached the correct overall conclusion in relation to the non-recoverability of the mark-to-market loss and the appeal must be dismissed **[96]**.

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: https://www.judiciary.uk/judgments/