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New Scope of Duty Test in Professional Negligence

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The UK Supreme Court has significantly reformulated the scope of duty test that applies in cases of professional negligence. It handed down its decision in the case of *Manchester Building Society v Grant Thornton UK LLP* [2021] UKSC 20 on 18 June 2021. Squire Patton Boggs' Manchester office acted on behalf of Manchester Building Society, who were successful in the Supreme Court.

The case was twinned with an unrelated claim also concerning scope of duty in a professional negligence context (Khan v Meadows). In that case, a doctor negligently advised a patient that she was not at risk of passing on haemophilia to any child she might have.

The same expanded constitution of seven judges, which included both the President and Deputy President of the Court, heard both cases. The aim of the Court was to "provide general guidance regarding the proper approach to determining the scope of duty and extent of liability of professional advisers in the tort of negligence." The combined judgments run to over 200 pages and the result is a significant broadening and simplification of the scope of duty gateway to the recovery of compensation from negligent professionals.

The Facts

Manchester Building Society hedged a portfolio of lifetime mortgages with long term interest rate swaps. The value of the swaps fluctuated according to interest rates and their value had to be reported in the Society's accounts. That would have produced an unacceptable level of volatility in the Society's profit and loss and regulatory capital. In order to mitigate this, the Society adopted IAS 39 hedge accounting. This allowed it, under tightly specified circumstances, to adjust the carrying value of the lifetime mortgages to offset any changes in the value of the swaps.

The Society sought advice from its auditors, Grant Thornton, before purchasing the mortgages and swaps and before adopting hedge accounting.

Grant Thornton incorrectly advised the Society that its combination of swaps and mortgages passed the stringent tests applicable to the use of hedge accounting. Grant Thornton repeated this same incorrect advice in each annual audit.

Once it was discovered that the Society could not apply hedge accounting, the negative swing in its reported profit and loss and capital position compelled it to exit the business model, breaking the swaps and selling the mortgages. The Society claimed from Grant Thornton the money it had to pay the swap counterparties for breaking the swaps. Grant Thornton admitted negligence but defended liability on the basis that the swap break costs did not fall within its scope of duty when it gave the advice and undertook the audits.

The Lower Courts

Whilst the Commercial Court awarded damages to MBS under certain other heads of loss, the Commercial Court and Court of Appeal both found in favour of Grant Thornton in relation to the swap break costs but on differing grounds. The Commercial Court applied the orthodox scope of duty test but then added in a second limb whereby the Court should "stand back and view the matter in the round". The judge (Teare J) found that the Society failed that test and found in favour of Grant Thornton on, essentially, policy grounds.

The Court of Appeal rejected Teare J's approach and dispensed with any policy filter above and beyond the orthodox test. It held that the test laid out in Hughes-Holland v BPE had to be strictly and literally adhered to. Firstly, the Court had to decide if the professional provided "information" or "advice". If the professional provided advice, the professional would be liable for "all the foreseeable consequences of entering into the transaction". If the professional provided information then the gateway to liability was the counterfactual test whereby a Claimant had to prove that it would not have suffered the loss if one assumed the negligent advice was in fact correct and the world was as described by the Defendant.

The Court of Appeal held that this was an information case and so on the facts of this claim, the Society would have to prove what would have happened to swap rates and mortgage rates for the next 40+ years. Whilst that was impossible, it was a necessary hurdle for the Society to clear.

Supreme Court Decision

The Supreme Court ruled unanimously in favour of the Society but it produced three differing judgments. The majority of five produced the leading judgment. They held that the "information v advice" test laid out in SAAMCO and fortified by BPE should be dispensed with. They further went on to say that the counterfactual test, so long the touchstone of liability, was no longer the core question.

It was of some utility in sense checking the scope of duty in simple factual circumstances but should never be relied upon as the main test and should be abandoned entirely in complex factual situations. As the Court explained; "One has to take care, therefore, not to allow the counterfactual analysis to drive the outcome in a case.

To do so would create a risk of litigation by way of contest between elaborately constructed worlds advanced by each side, which would become increasingly untethered from reality the further one moves from the relatively simple valuer case addressed in SAAMCO".

In place of the two stage information v advice question and the subsequent counterfactual test, the Court preferred a simplified test whereby the scope of duty "is governed by the purpose of the duty, judged on an objective basis by reference to the purpose for which the advice is being given". The test to be applied is now "in the case of negligent advice given by a professional adviser 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".

The Court did not use the expression "the very thing", but if one is looking for a bite size take away from this judgment it is that, in practical terms, the scope of duty test has become the question; "Is this loss the very thing that the professional advice was supposed to guard against?"

Comment

We welcome the decision on behalf of our longstanding client, Manchester Building Society, after what was a six year journey through the Courts. The difficulty of the scope of duty question in a complex case such as this is evidenced by the fact that three different Courts took three very different views of both the test and the proper outcome. The centrality of the test is reinforced by the Supreme Court constituting a seven member panel to fully reconsider the law in this area.

Whilst the Court stated that it was following SAAMCO and BPE, in reality the test has shifted significantly away from that propounded in those cases. In particular, it is right that the strict adherence to the counterfactual question has now gone. The counterfactual test works well in very simple cases but once the facts become complex and the repercussions of the negligent advice diverse, the proper formulation of the counterfactual world becomes impossible.

Claimants who have suffered loss as a result of negligent advice are likely to turn to this judgment as providing both a more generous and more common sense test for scope of duty. Professionals giving advice should pay heed to the "purpose of duty" question and make sure that their terms of engagement are absolutely clear on the agreed purpose of the advice being sought.

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