Feature

KEY POINTS

- The "descriptive inadequacy" of the "information" and "advice" labels does not undermine the distinction between the two categories. It is important not to shortcut the application of that distinction.
- Filters of causation and foreseeability apply to both.
- In "information" cases, there is an additional filter – there is no liability for losses which would still have been suffered even if the erroneous information had been correct.

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Information v advice: inadequate labels but important principles

In this article, Matthew Bradley and Tom Asquith consider the recent Court of Appeal decision in *Manchester Building Society v Grant Thornton UK LLP*. It is an application of the "*SAAMCO* principle" in the context of financial advice. The authors provide points of note for practitioners looking to draw a line between taking responsibility for a decision and merely providing information which feeds into that decision.

INTRODUCTION

The claimant building society (MBS) was involved in the lifetime home equity release mortgage market in both the UK and Spain. It hedged its interest rate risk associated with this market by entering into a number of interest rate swaps with lengthy terms of up to 50 years.

From 2005 onwards, MBS was required to prepare its accounts in line with International Financial Reporting Standards (IFRS). As a result, the swaps had to be included on MBS' balance sheet, valued at fair value. The fair value of a swap is its full mark-to-market value, which is the market's assessment of the future payments that will be made over the entire term of the swap between the counterparties, discounted to a net present value.

Accounting for swaps at fair value had the detrimental effect of potentially causing significant volatility in MBS' reported financial position. The solution arrived at by MBS was to use hedge accounting. This allowed adjustments to be made to the value of the lifetime mortgages which reduced the changes in their fair value and, in turn, the level of volatility shown in the accounts.

In April 2006, the defendant accountants (GT) advised MBS that it could apply hedge accounting to the interest rate risk under the lifetime mortgages and the corresponding swaps.

GT audited MBS' accounts from 1997 to 2012. MBS followed GT's advice and applied hedge accounting when preparing its financial statements for the years ending 31 December 2006 to 2011. GT provided unqualified audit opinions for these years, confirming that the financial statements gave a true and fair view of MBS' financial position.

In March 2013, GT informed MBS that it might not be entitled to employ hedge accounting. As a result, MBS found itself with insufficient regulatory capital. Accounting for the fair value of the swaps had a dramatic negative effect on MBS' profits and net assets. The variable rate of interest had dropped since the financial crisis, leading the market to forecast that the variable rates would be less on average than the fixed rates which MBS had to pay. They were, therefore, "out of the money".

Because of the risk to which MBS was exposed, it closed out the swaps at fair value in June 2013. As well as a multimillion pound loss on the swaps themselves (the MTM losses), MBS incurred just over £285,000 of transaction costs, and other losses such as costs of advice and redundancy.

GT admitted in its Defence that its advice and audits were negligent. MBS was not, in fact, entitled to apply hedge accounting. The reasons for this included the difference in temporal length of the mortgages and the longer swaps.

Had GT advised that hedge accounting was not an available option, MBS would not have taken out any more long-term swaps from April 2006 and would have broken the swaps which it had already entered into.

FIRST INSTANCE DECISION

Breach of duty having been admitted, the question for Mr Justice Teare was the extent of any liability of GT. He found that GT had, both as a matter of fact (under the "but for" test) and as a matter of law (under the "effective cause" test) caused MBS' losses. He also found that the losses sustained by MBS when it broke the swaps in 2013 were reasonably foreseeable and not too remote. He nevertheless held that MBS' losses fell outside of GT's scope of duty.

Both parties had contended that the judge should consider whether, in line with the *SAAMCO* line of authority (see *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd* [1997] A.C. 191, known as *SAAMCO*, and *Hughes-Holland v BPE Solicitors* [2017] 2 W.L.R. 1029), this was an "advice" case or an "information" case.

Instead of answering that specific question, the judge had focused on considering whether the losses which MBS sought to recover were losses for which GT had assumed responsibility, ie whether they were within GT's scope of duty. He cited para 39 of *Hughes-Holland* in which Lord Sumption had said of the classic "advice" v "information" dichotomy:

> "Turning to the distinction between advice and information, this has given rise to confusion largely because of the descriptive inadequacy of these labels. On the face of it they are neither distinct nor mutually exclusive categories. Information given by a professional man to his client is usually a specific form of advice, and most advice will involve conveying information."

As a result, he held at para 151 that "Little is to be gained" from such considerations. Instead he preferred to focus on what Lord Sumption had said at para 44 of *Hughes-Holland*, that apart from cases at the extremes "every case is likely to depend on the range of matters for which the defendant assumed

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responsibility and no more exact rule can be stated".

The judge recorded that both parties had made cogent arguments to him as to whether MBS had established an assumption of responsibility by GT. It was not an easy question to answer. Ultimately, he found that the MTM loss was not one for which GT had assumed responsibility. That loss had flowed from market forces for which GT had assumed no responsibility, just like the risk of a counterparty exercising its right to terminate a swap.

Albeit unnecessary for his decision, he then considered the application of the *SAAMCO* principle. If the information or advice had been true, the loss would not have been suffered, because the swaps would not have been closed out. So, on a *SAAMCO* analysis, MBS would have recovered its MTM losses.

THE ISSUES BEFORE THE COURT OF APPEAL

MBS appealed the judge's decision on various grounds. The arguments were as follows:

- The judge should have considered whether this was an "advice" or "information" case, not simply whether responsibility had been assumed for the loss in question. According to MBS, by failing to do so, the judge erred in law.
- MBS argued that this was an advice case, such that GT was liable for the MTM losses. GT argued the contrary.
- MBS argued that if this was an information case, the MTM losses were within GT's scope of duty. GT argued the contrary. Causation of loss falling within the scope of duty was not demonstrated: MBS had failed to prove that it would not have suffered the loss in any event.
- MBS lastly argued that, even if the relevant question was simply whether or not there had been an assumption of responsibility, the MTM losses should have been recoverable.

THE COURT OF APPEAL'S DECISION

Lord Justice Hamblen gave the leading judgment, with which Lord Justice Males and Dame Elizabeth Gloster agreed.

In short, the first instance decision was upheld, but for different reasons.

The use of inadequate labels

The court restated the key principles from the *SAAMCO* and *Hughes-Holland* cases, including the following:

- "An 'advice' case is where 'it is left to [the] adviser to consider what matters should be taken into account in deciding whether to enter into the transaction. His duty is to consider all relevant matters and not only specific matters in the decision.' He is 'responsible for guiding the whole decision making process' [40]. In such circumstances 'the adviser's responsibility extends to the decision' to enter the transaction and he is liable for the foreseeable losses flowing from having entered into it." (para 51).
- "Unless the adviser is 'responsible for guiding the whole decision making process' in the way described, it is an 'information' case. In an 'information' case the adviser or information provider is not responsible for the decision to enter into the transaction and is accordingly not responsible for all the foreseeable financial consequences of doing so. He is only responsible for the foreseeable financial consequences of the information or advice being wrong [41]." (para 52).
- "In order to determine what are the foreseeable financial consequences of the information or advice being wrong it is necessary to exclude all losses which have been suffered if the information or advice had been correct – the '*SAAMCO* cap'." (para 53).

Hamblen LJ found:

> "'This was clearly a case in which the SAAMCO principle applied."

The judge had erred in not paying regard to the "advice/information" distinction. He had done so largely because of Lord Sumption's reference to the inadequacy of the labels. But that inadequacy did not, said Hamblen LJ, "undermine the fact that there is a clear and important distinction between the two categories of case" and he referred to dicta of Lord Sumption elsewhere in *Hughes-Holland* in support of that proposition.

In short, an "information case" is something of a term of art, as used in this context. As explained by Lord Sumption in *Hughes-Holland*, information given by a professional man to his client is usually a specific form of advice, and most advice will involve conveying information. The real distinction lies in whether or not the adviser contributed a limited part of the material on which his client relied in deciding whether to enter into a prospective transaction – against a background in which the process of identifying the other relevant considerations and the overall assessment of the commercial merits of the transaction remained the client's preserve. In such "limited professional contribution" cases (ie "information cases"), an adviser is liable only for the financial consequences of the advice or information being wrong, and not for the financial consequences of the claimant entering into the transaction, in so far as they are greater.

Hamblen LJ effectively reiterated this analysis, with the effect that MBS established an error of law, in the judge's failure to apply the advice/information distinction.

"Advice" v "information"

Although GT gave advice, this was clearly an "information" case because GT's advice about the accounting treatment of hedging plainly did not guide the whole decision-making process about hedging itself (ie entering into the swaps) (para 64).

GT therefore won on this issue.

MTM losses and scope of GT's duty

In arguing that the MTM losses fell within the scope of GT's duty, MBS relied on the judge's findings that, had GT's advice been correct "the Claimant would not have broken the swaps in 2013 and so would not at that time have incurred the loss which in fact it did".

GT argued that the losses in fact flowed from interest rate movements, and not from MBS' breaking of the swaps, which simply crystallised the market losses. To show that breaking the swaps had, in and of itself caused

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loss, MBS had to show that maintaining the swaps would have led to a better outcome. It was unable to do this on the evidence. Indeed, the MTM value in 2013 (which was agreed to be a fair value) was the best evidence of the true value of the swaps. It would be difficult to show that breaking the swaps later would have been better for MBS.

The court accepted GT's arguments. It noted that it was possible to imagine a claimant being able to show that, had it not been compelled to close swaps at a specific date, a later and more advantageous date could have been relied on. However, that was not MBS' case.

If the judge had been right in law to apply the assumption of responsibility test, was he wrong in fact to find the losses fell outside the assumed responsibility?

Because the Court of Appeal held that the judge had failed to apply the correct legal test, this issue did not arise. Hamblen LJ did however note that, having found this to be an "information" case, it necessarily followed that GT did not assume responsibility for the swap transactions, but only for the financial consequences of its advice as to hedge accounting being wrong. Near the end of the judgment, Hamblen LJ endorsed the judge's observation that it would be "… a striking conclusion to reach that an accountant who advises a client as to the manner in which its business activities may be treated in its accounts has assumed responsibility for the financial consequences of those business activities … ".

POINTS OF NOTE

This application of the *Hughes-Holland* guidance in the financial context provides helpful reassurance that the "information"/"advice" distinction is simply shorthand for a useful tool for lawyers. It does not necessarily correlate with whether a defendant gave information or advice, as Lord Sumption said in *Hughes-Holland*. There is no need for defendants to strain to avoid the word "advice" in their letters of response and defences, as they previously often did. The focus instead should be on considering whether the defendant assumed responsibility for the decision as a whole, or merely the consequences of his information/advice being wrong.

Drawing a line between taking responsibility for a decision and merely providing information which feeds into that decision is not at all easy. On one view, a client will always retain some responsibility for a transaction, because only the client is likely to be aware of the full menu of options available to it. Even if GT had provided fuller advice, extending beyond the accounting treatment of the interest rate swaps to the merits of the swaps themselves, it could be argued that MBS would have retained a role in the decision-making process for entering into the interest rate swaps; only it would have known what other options were available to it in all the circumstances. Under that scenario, GT could have argued that it provided advice on various parts of the transaction but did not consider all of the matters which were to be taken into account.

The authors suggest that an important step in the "information"/"advice" categorisation is the proper analysis of the true nature of the transaction which went wrong. Was it the entering into of product X? Or was it the entering into of a product of X's type? The narrower the characterisation of the transaction, the more likely a claimant will be able to show that a defendant took responsibility for the "whole decision-making process", and vice versa. Take the example of a mortgage adviser who negligently recommends an unnecessarily expensive product. It is easy to imagine that mortgage adviser taking responsibility for the whole decision making process if that transaction was, simply, entering into a mortgage. But if the mortgage was instead entered into in order to raise finance to redeem unsecured loans owed by a sister company, it might be possible for a defendant to argue that the transaction was in fact the restructuring of a group's finances, into which process he provided only some specific and limited input.

As to the line between what is foreseeable and what is not, para 53 of the court's judgment is instructive. All losses which would have been suffered if the information or advice had been correct are excluded. In this way a defendant is only liable for loss flowing from the information or advice being wrong, not those losses which otherwise arose from the decision to enter into the transaction.

This underlines how, post *Hughes-Holland*, claimants face a difficult burden of proof to discharge. Effectively, they have to prove a negative: that the loss in question would not have been suffered, even if the information provided by the defendant had been correct. As this case demonstrates, that is no easy task. ■

Further Reading:

- SAAMCO – back with a hard edge in *BPE v Hughes-Holland* (2017) 6 JIBFL 346.
- Information or advice: the value judgment (2015) 11 JIBFL 693.
- LexisPSL: Banking & Finance: News: Recovering a loss – assessing the scope of the SAAMCO principle.