COVID-19 and damages for negligent advice

Tom Leary

The COVID-19 pandemic has caused historic losses across financial markets and business, exacerbated by the oil price war between OPEC and Russia. What is next for companies and investors who face losses as a result of what are now extremely disadvantageous transactions?

Stuck with a disadvantageous transaction?

It is unsurprising that thoughts have turned to the application of force majeure clauses or the doctrine of frustration as possible escape routes, but those options are rarely straightforward and parties might do better by negotiating a mutually acceptable solution.[1]

Insurance could be one means of recovering losses but many business interruption policies are dependent on damage to property and will exclude pure financial losses arising from pandemics.

However, all is not necessarily lost for the uninsured client. Claims against professional advisers tend to rise at times of crisis, as they did following the 2008 housing market crash, and it is worth considering whether any negligent advice was given about the loss-making transaction. If it was, it may be possible to shift the risk of COVID-19 market losses to the adviser.

1 See Hugo Lidbetter's article: https://www.linkedin.com/pulse/force-ma-jeured-dont-necessarily-follow-herd-hu-go-lidbetter/

Recovering COVID-19 losses from professional advisors

Concurrent claims in contract and tort

Most professional advice is given pursuant to a contract and it will therefore be possible to bring concurrent claims against negligent advisers in contract and tort.

The scope of the contractual and tortious duties will generally be the same (see *SAAMCO v York Montague Ltd* [1997] AC 191) and the contractual test for remoteness will be applied to both claims (see *Wellesley Partners LLP v Withers LLP* [2016] Ch 529 at [80].

Does the adviser assume the risk of COVID-19 losses?

The scope of the adviser's duty of care has to be determined before it can be said that the advisor has assumed the risk of COVID-19 market losses. Much will turn on whether the case is one of "information" or "advice".

In SAAMCO [1997] AC 191, the House of Lords held that the lenders could not recover from their valuation advisers all of their losses in entering into loan arrangements on the basis of negligent overvaluations of property. A significant portion of the total loss was attributable to a fall in the property market. Lord Hoffmann distinguished between (i) a duty to provide information (like an accurate valuation) for the purpose of enabling someone else to decide upon a course of action and (ii) a broader duty to advise someone as to what course of action he should take. The valuers had only provided "information", not general transaction "advice", and their liability was limited to the foreseeable consequences of their information being wrong. It did not extend to the market losses suffered by the lenders in entering into the loan transactions.

In *Rubenstein v HSBC Bank Plc* [2012] EWCA Civ 1184, on the other hand, the Court of Appeal dealt with an "advice" case in which a bank had negligently recommended a bond investment and advised that it was the same as a cash deposit (it was in fact subject to market conditions). When the market collapsed, the bank was held liable for the claimant's losses despite the extraordinary and unprecedented financial turmoil. Rix LJ commented at [103] that the adviser had

> "not only advised Mr Rubenstein on the investment of his capital, he recommended a particular investment. He, so to speak, put him in it. If such an investment goes wrong, there will nearly always be other causes (bad management, bad markets, fraud, political change etc): but it will be an exercise in legal judgment to decide whether some change in markets is so extraneous to the validity of the investment advice as to absolve the adviser for failing to carry out his duty or duties on the basis that the result was not within the scope of those duties".

In *Hughes-Holland v BPE Solicitors* [2018] AC 599, the Supreme Court re-affirmed the SAAMCO cap (that in an "information" case the recoverable

damages exclude losses which would still have been suffered even if the erroneous information had been correct) and gave some further guidance on the line between "advice" and "information" (see [40]-[41]). Lord Sumption explained that in an "advice" case

> "if the adviser has negligently assessed risk A, the result is that the overall riskiness of the transaction has been understated. If the client would not have entered into the transaction on a careful assessment of its overall merits, the fact that the loss may have resulted from risks B, C or D should not matter" (see [40]).

In *Manchester Building Society v Grant Thornton UK LLP* [2019] 1 WLR 4610, the Court of Appeal found that an auditor's advice to a building society, that it could apply hedge accounting to reduce the effect in its accounts of the volatility of the mark-to-market value of interest rate swaps, did not make it liable for all the foreseeable financial consequences of the swap transactions (including the market losses in closing out the swaps after a fall in interest rates). Hamblen LJ explained that

> "unless the adviser is 'responsible for guiding the whole decision-making process' in the way described [in Hughes-Holland], it is an 'information' case" (see [52]).

An "advice" case was held to be one where:

1. It can be shown that it has been left to the adviser to consider what matters should be taken into account in deciding whether to enter into the transaction.
2. His duty is to consider all relevant matters and not only specific matters in the decision.
3. He is responsible for guiding the whole decision-making process (see [54]).

It was clear in this case that Grant Thornton had given accounting advice only. It was not involved in the decision to enter into the swaps, nor had it guided the whole decision-making process.

It appears that extreme market losses, such as those caused by COVID-19, could be recovered from a negligent adviser in an "advice" case even if the negligent advice in question did not relate to that kind of risk.

However, caution will need to be exercised when advising clients about the recovery COVID-19 market losses, given the uncertainty about how the advice/information distinction will be applied in practice, and although COVID-19 market losses are likely to provide an opportunity for the Courts to clarify these principles in professional negligence cases, careful advice and argument will be needed for both clients and advisers.

Remoteness

Assuming that one is dealing with an "advice" case in which COVID-19 market losses are recoverable in principle, the next question will be whether those market losses are the foreseeable financial consequence of the breach of duty, or whether they are too remote.

Where concurrent claims are brought in contract and tort, the contractual test for remoteness will be applied to both claims (see *Wellesley Partners LLP v Withers LLP* [2016] Ch 529 at [80]), i.e. whether, at the time of making the contract, a reasonable person in the shoes of the contract-breaker would have had damage of the kind suffered in mind as not unlikely to result from a breach (see [69]). This gives rise to two uncertainties.

The first uncertainty is whether, and if so how far, remoteness operates as an additional limit on liability after the scope of the duty of care has been determined.

There are clear parallels between the contractual "assumption of responsibility" analysis of Lord Hoffmann and Lord Hope in *The Achilleas* [2009] AC 61 (dealing with remoteness) and the "scope of duty" analysis in *SAAMCO* [1997] AC 191. In *Roe v Minister of Health* [1954] 2 QB 66 at 85, Denning LJ pointed out that questions of duty, causation and remoteness are intimately linked and all directed to the same fundamental question:

> "Is the consequence fairly to be regarded as within the risk?"

However, it seems tolerably clear that remoteness remains separate to the "scope of duty" analysis, and operates as an additional filter on the recovery of damages for market losses, even if the precise relationship between the two has not yet been fine-tuned by the courts (see *Wellesley Partners LLP v Withers LLP* [2016] Ch 529 at [74] and *Manchester Building Society v Grant Thornton UK LLP* [2019] 1 WLR 4610 at [49]-[50]).

The second uncertainty is how far (at least on the contractual test of remoteness) it is open to defendants in an "advice" case to argue that extreme COVID-19 market losses are too remote to be recovered (even where they have assumed general responsibility for the financial risk of the transaction).

The starting point is that the loss must be of a kind which the defendant, when he made the contract, ought to have realised was "not unlikely" to result from the breach, those words denoting a

degree of probability considerably less than an even chance but nevertheless not very unusual and easily foreseeable: see *The Heron II* [1969] 1 AC 350 at 382-382.

Can market losses incurred due to the extreme COVID-19 market volatility be excluded as "very unusual" or unlikely kinds of loss?

The decision in *The Achilleas* [2009] AC 61 indicates that (for at least some types of contracts) losses resulting from unusual market volatility may be treated as being too remote to be recovered (see also *Sylvia Shipping Co Limited v Progress Bulk Carriers Limited* [2010] 2 Lloyd's Rep 81 from [26]).

However, in cases of negligent financial or investment advice the position is different. Market movements, even extreme ones, would appear to be eminently foreseeable in that context and it may be difficult for a financial adviser to successfully distinguish between losses caused by the "normal" vicissitudes of the market and those triggered by an "abnormal" global pandemic.

It seems that losses caused by even unprecedented market turmoil or hysteria should not generally be treated as being too remote in the context of financial or investment advice (see *Rubenstein v HSBC Bank Plc* [2012] EWCA Civ 1184), unless perhaps the losses arise not from volatile market conditions but from other circumstance such as the wholly unforeseeable collapse of a company (see, for example, the possible distinction between (i) advice as to the suitability of an investment in terms of "its logic and risk" and (ii) advice as to "issuer default" risk, in *Camerata Property Inc v Crédit Suisse Securities (Europe) Ltd (No 2)* [2012] EWHC 7 (Comm), [2012] PNLR 15 (discussed in *Rubenstein v HSBC Bank Plc* [2012] EWCA Civ 1184 at [110]-[112])).

Conclusion

Where a client is stuck with a disadvantageous transaction as a result of the ongoing COVID-19 crisis, and cannot rely on insurance to cover its losses, one option is to consider whether negligent advice was given when the client entered into the transaction.

Where the scope of the advice is sufficiently broad that the adviser assumed responsibility for guiding the whole decision-making process, losses attributable to COVID-19 market volatility may well be recoverable from the adviser (provided that they are not too remote or so extraneous to the advice that the adviser should be absolved from the consequences of failing to carry out his duty).

In cases of negligent financial or investment advice, it seems likely that extreme market losses will be recoverable, though certain categories of loss (such as those caused by an unforeseeable issuer default) may be too remote.

In any event, COVID-19 is likely to cause a spike in negligent advice cases, affording the Courts new opportunities to further clarify the circumstances in which negligent professional advice will shift the risk of catastrophic market events from the client to the adviser.

This note does not constitute, and should not be relied upon as, legal advice.

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