AssetCo Plc v Grant Thornton UK LLP [2020] EWCA Civ 1151

Demonstrating its activity over the summer, on 28 August 2020 the Court of Appeal (David Richards LJ, Phillips LJ and Sir Stephen Richards) handed down its judgment in this notable decision on the assessment of loss in auditors' negligence cases. While not breaking new ground, the Court provided useful clarification on applying *SAAMCO* in the case of a general statutory audit, and on the approach to loss of a chance where there is strong factual evidence from third parties as to what they would have done.

The Court concluded that *SAAMCO* applied, but that ultimately it was a tool for determining whether loss fell within the scope of the auditors' duty of care, not a rigid rule of law. The auditors' failures to detect dishonest concealment of the insolvent position of AssetCo had prevented the company calling its senior management to account and correcting their errors, which was the principal purpose of an audit. Losses resulting from AssetCo continuing to fund its subsidiaries for a further 2 years were therefore within the scope of that duty.

On loss of a chance, the Court refused to interfere with the judge's decision that having assessed certain contingencies as greater than 90%, he would make no discount. Evaluating a hypothetical was not a precise art, and this could fairly be treated as a certainty.

The Facts

AssetCo Plc was the holding company of a group carrying on businesses related to fire and rescue services, predominantly under contracts with the London Fire and Emergency Planning Authority, Lincolnshire County Council and the UAE Armed Forces. These it operated through subsidiaries.

Grant Thornton ("GT") was instructed to audit AssetCo's financial statements and those of its subsidiaries for the years ending 31 March 2009 and 31 March 2010. During this period, AssetCo's senior managers behaved fraudulently in various ways in their conduct of and representations about the business, including of the subsidiaries. It was common ground that it was only because of dishonest representations by senior management that the business of the AssetCo group appeared to be sustainable and solvent at all, when in fact it was not.

GT admitted extensive breaches of duty, in particular in not identifying this management fraud. It also admitted that if it had acted with proper care and skill, this would have revealed that AssetCo's business was only "ostensibly sustainable" because of the dishonest representations by senior management.

The result of the negligence was that the assets of AssetCo were overstated by £120 million and that AssetCo was said to be a going concern when it was, in fact, insolvent.

AssetCo claimed that, but for the negligence, the true state of the company's affairs would have been discovered in 2009 or 2010 and events would have followed the same course as they did when the truth was actually discovered in 2011. The "counterfactual" included that refinancing would have been possible, intervention triggered, an interim chairman appointed, agreement with creditors would have been reached by way of a scheme of arrangement, and significant changes made to the business and financial model. AssetCo would have avoided considerable wasted expenditure between 2009 and 2011, in the region of £31 million. This mainly resulted from funding to its subsidiaries. In terms of causation and loss, AssetCo's primary case was that it was entitled to recover the losses in full having proved its case to the civil standard. In the alternative, AssetCo claimed for the loss of a chance to restructure and refinance its business in 2009/2010 and avoid the losses it said it had suffered.

GT denied that AssetCo sustained any loss or any recoverable loss and denied that events in the counterfactual would have unfolded as pleaded.

At First Instance

After a 20 day hearing, Bryan J held, in a 493-page judgment, that the counterfactual situation would have occurred. He rejected GT's argument that such trading losses fell outside the scope of an auditor's duty, found that they were not too remote and that AssetCo had mitigated its loss. Damages were reduced by 25% to reflect AssetCo's contributory fault. GT were ordered to pay damages of just over £~22.36 million.

The Appeal

The appeal was brought by GT on three grounds:

1. Bryan J erred in his approach to scope of duty and legal causation. He had failed to apply the "*SAAMCO* cap" when deciding whether the trading losses could be said to fall within the scope of its duty.
2. Bryan J erred in his application of the principles for awarding damages for loss of a chance in finding that the counterfactual situation was established on a 100% basis thereby adopting an impermissible 'rounding up' exercise.
3. Bryan J failed to give credit for benefits received by AssetCo.

David Richards LJ gave the lead judgment in the Court of Appeal, which dismissed GT's appeal in relation to scope of duty and legal causation (save for one small element). It also dismissed GT's appeal on the assessment of loss of a chance. On the third ground of appeal, the Court held that the correct principles had been identified, but credit should have been given for a share placing that was "part and parcel" of AssetCo's "ostensibly sustainable" business, and amounted to approximately £7.5 million. Damages were reduced accordingly.

Discussion

Scope of duty

The case is most interesting for its discussion of how *SAAMCO* [1997] 1 AC 191 should be applied in a general audit case, i.e. where auditors were carrying out their duty to the company to carry out an audit of its accounts, rather than giving advice on any specific matter. AssetCo sought to argue that *SAAMCO* should not be applied at all in such a situation, on the basis that the information/advice distinction in *SAAMCO* and in *Hughes-Holland v BPE* [2017] UKSC 21 was directed to advice on a particular transaction, whereas an audit report related to all matters which the directors were required to report on in the accounts.

The Court of Appeal rejected that contention. David Richards LJ concluded [101] there was no good reason why the *SAAMCO* principle should not in most circumstances be applied to determine whether particular losses came within the scope of the auditor's duty. He said the purpose of the principle was to distinguish the negligent audit which was merely the occasion for the loss from the one which gives rise to a liability to make it good.

This formulation is of course essentially indistinguishable from the test for legal causation in a professional negligence dispute like this one. It is notable that both Bryan J and the Court of Appeal considered that the arguments and evidence relevant to *SAAMCO* scope of duty, and to legal causation were the same, even while accepting they were separate concepts. This may have had a lot to do with how the case was argued at first instance, where neither side really raised *SAAMCO* at all. A change of leading counsel on the defendant side brought *SAAMCO* much more strongly to the fore in the Court of Appeal. However David Richards LJ was not willing either to say that *SAAMCO* was irrelevant, or that AssetCo was prevented from running arguments on *SAAMCO* in the Court of Appeal because it had not made a case on it before the judge. He concluded that the answer to the *SAAMCO* issue could be determined from the evidence as a whole, without any need for it to have been separately addressed in the evidence [89]. Therefore, he said, the fact the judge was not invited to address *SAAMCO* by either party did not inhibit the Court of Appeal from doing so.

The key, as the Court of Appeal saw it in applying *SAAMCO*, was that when the 2009 audit was carried out, the business was only ostensibly sustainable at all because of the dishonest representations and unreasonable decisions of management which GT should have uncovered and reported. It was that specific breach of duty which allowed AssetCo to continue trading, and to continue pumping money into its subsidiaries, which was the cause of the bulk of its claimed losses [107-8]. The principal purpose of an audit was to enable a company, by its shareholders or non-executive directors, to call senior management to account and correct errors. That was precisely what the breach prevented them from doing. Therefore this was within the scope of the duty of care.

As a result of its analysis, the Court of Appeal did partially allow the appeal, in respect of a relatively small, separate head of loss, which resulted from one of the directors misappropriating company funds for his own benefit. This was insufficiently connected to the continuation of the loss-making business which was the consequence of the negligence.

The Court of Appeal did not apply the classic "would the same loss have occurred even if the audit result had been true?" formulation of the *SAAMCO* test, but this was probably difficult to do given the way the case had developed.

However, simply requiring a clear link between the auditor's negligence and the continuation of an "ostensibly sustainable" business in this way has the potential to draw a lot of losses within the scope of the duty of care. One of the difficulties which claimants have always faced in negligence claims against auditors carrying out a general audit is in claiming for trading losses where the consequence of the negligence has been that an insolvent company has continued to trade. This formulation of the *SAAMCO* duty by the Court of Appeal in *AssetCo* gives claimants a potential way to do this, where there is a sufficiently close connection between the continued trading and the particular breaches of duty.

Loss of a chance

In proving its counterfactual as to what would have happened if GT had not been negligent (factual causation), AssetCo had some significant advantages. Its case was that essentially the same steps would have been taken to save the business as were actually taken 2 years later. Some of the necessary steps were AssetCo's own (proved on the balance of probabilities), but some depended on the actions of third parties. These included individuals whom it called as witnesses, including the interim chairman appointed, who said he would have been available and taken the same steps, earlier.

Bryan J had treated this as a loss of a chance case, but had concluded that the chances were so high (assessing the various contingencies as either a certainty or a chance in excess of 90%) that no discount to the damages should be applied.

In the Court of Appeal, GT argued that there were a number of separate contingencies which he had effectively treated as 90%, and these 90% contingencies should then be multiplied together to arrive at a (much larger) final discount. GT also argued that some of the contingencies should have had a much lower percentage applied.

The Court of Appeal confirmed that the judge's decision was an assessment of the chances of a hypothetical fact, applying *Perry v Raleys Solicitors* [2019] UKSC 5, not a finding of fact on the balance of probabilities. As such it was an evaluation, but one where the trial judge enjoyed significant advantages over the Court of Appeal. They should not interfere unless there was a flaw in his reasoning or it was not a conclusion reasonably open to him on the evidence. This is an important marker for those considering appealing such evaluative conclusions on loss of a chance.

The Court rejected all of GT's challenges to the percentage contingencies applied. There was ample supporting evidence for the judge's conclusions. In addition, while it was accepted that a mathematical approach – multiplying the contingencies – should be applied where contingencies were truly independent, many here were not.

Finally the Court supported the judge's position that where he had concluded that a chance was greater than 90%, it was reasonable to treat this as a certainty. This was not rounding up; it was concluding that, within the confines of judicial decision-making, this was a certainty. Assessing the percentage chance of such contingencies was not a precise mathematical exercise and the judge was entitled to conclude that a distinction between certain and almost certain was meaningless.

This case therefore usefully confirms earlier authorities to the effect that where the evidence is strong enough, a finding of no discount for loss of a chance – or indeed a 100% discount – is perfectly possible and legitimate.

Credit for benefits

Given the conclusions on scope of duty and loss of a chance, the final issue of whether AssetCo should have to give credit for benefits which GT said it had received from continuing to trade as it did, really mattered. Where there are said to be losses from continuing to trade, there are likely to be arguable countervailing benefits to be considered.

In reliance on the Supreme Court decision in *The New Flamenco* [2017] UKSC 43, the Court accepted that "but for" causation of the receipt of benefits (i.e. from continuing to trade) was insufficient; for credit to be given, a benefit must also have been legally caused by the breach.

Some of the supposed "benefits" (such as an overdraft and a loan) were not in truth benefits at all, because AssetCo also had a countervailing liability.

However the share issue in 2009 was undertaken in the course of the same "ostensibly sustainable" business that AssetCo had been deprived of the opportunity to prevent by GT's breach. This close connection meant legal causation was satisfied. Credit therefore had to be given for the £7.5m odd raised. The same did not apply to a much later share issue which was initiated not because of the audited accounts, but precisely because the group was by then known to be in serious financial difficulty. This illustrates the importance of a careful analysis of how any "benefits" actually came about.

In this way, the links made in the scope of duty part of the judgment followed through to the credits which had to be given for benefits.

Auditors negligence cases rarely reach a full trial, so this case has provided a good opportunity to shake down many of the causation and quantum issues that they raise.

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