Dispute Resolution
Dispute Resolution Case Law Update
Rosling King LLP

Background

The Claimant, AssetCo, a fire and emergency services provider, had engaged the Defendant, Grant Thornton ("**GT**"), to audit its financial statements, those of its subsidiaries, and their consolidated statements for the financial years ended 31 March 2009 and 31 March 2010. In those years, the senior management team at AssetCo behaved in a way that was fundamentally dishonest. GT accepted that it was negligent in a number of respects as the company's auditor in failing to detect those matters and in giving the company clean bills of health. Following the appointment of new management in March 2011, AssetCo entered into a Scheme of Arrangement with its creditors.

AssetCo sought damages of around £30 million for breach of contract and/or in negligence arising out of the negligent performance by GT of its audit of the 2009 and 2010 accounts. It contended that, had GT acted as a competent auditor, events would have transpired as AssetCo asserted in its 'counterfactual', and also that AssetCo would have avoided expenditure. AssetCo's primary case was that it was entitled to recover those sums in full, having proved its case on the balance of probabilities. In the alternative, it claimed for the loss of a chance to restructure and refinance its business in 2009/10 and, therefore, avoid the losses that it said it had suffered.

GT resisted the claim, rejecting both the primary and alternative bases for it. Although GT admitted the majority of the alleged breaches of duty, and admitted that had the matters pleaded by AssetCo been apparent to it, it (i) would have uncovered many if not all of the instances of deceit of the GT audit team by the senior management of AssetCo; and (ii) would have issued a qualified opinion or resigned, it denied that any of the alleged breaches causes any loss to AssetCo. In fact, GT went so far as to allege that AssetCo had ended up better off as a result of GT's negligence, arguing that had the counterfactual scenario taken place, AssetCo could not have avoided insolvent liquidation. In the alternative, GT argued that even if its negligence did cause AssetCo to suffer losses, these were avoided or mitigated by AssetCo's entry into the Scheme of Arrangement in 2011.

GT further argued that it had a claim against AssetCo for deceit, for falsely representing to GT that all audit information had been made available to them during the audits.

Held

Mr Justice Bryan in summary held that AssetCo had proved its losses based on its counterfactual, in which GT had acted as competent auditor, and that AssetCo had not mitigated any loss which was caused by GT. Although Mr Justice Bryan did find that AssetCo was contributorily negligent in respect of some of the losses suffered (and this was taken into account in assessing quantum), including by the dishonesty of AssetCo's senior management and its failure to look after its own interests, he refused GT's application for relief from liability under section 1157 of the Companies Act 2006 (which can provide relief to auditors and others if they acted honestly and reasonably), as he found that GT had not acted reasonably. Mr Justice Bryan further rejected GT's deceit counterclaim, finding that such dishonesty was the

very thing that as auditor GT had been engaged to detect. Justice Bryan described the admitted shortcomings of GT as a "*catalogue of failures over two audit years that were of the utmost gravity and that went to the very heart of the auditor's duties*" (see para 1115). AssetCo was awarded damages in excess of £20 million.

Comment

Understanding GT's position

This case is the latest in a series of well-publicised high value claims against firms of auditors, at a time when the audit industry is facing extensive criticism and scrutiny from a range of different fronts. Indeed, in terms of understanding GT's defence, it is unsurprising that breach of duty and negligence was admitted in the circumstances. The precursor to the case was that in 2017 GT were fined £3.5 million (before settlement discount) by the Financial Reporting Council regarding GT's conduct of the 2009 and 2010 audits of AssetCo. GT's audit Partner Robert Napper was as a consequence also struck off the Institute of Chartered Accountants in England and Wales for three years with no automatic reinstatement, submitting to a fine of £200,000 (before settlement discount). Consequently, as set out above, GT's primary argument was that its actions had not caused any loss to AssetCo (rather than disputing liability for breach of duty and negligence).

MBS appealed this decision on the basis that the Judge should have followed *SAAMCO* and determined this to be an "advice" case. Alternatively, even if this was an "information" case, the Judge was wrong because the losses were reasonably foreseeable, and so the losses were within GT's scope of duty.

Key Takeaways

The judgment is lengthy and complex, and whist this note is not the forum for detailed dissection of the case, we set out our analysis on some key points of interest below.

Firstly, the judgment contains a comprehensive and detailed analysis of the principles applicable to the assessment of damages on the basis of 'loss of a chance'. It was held that where a claimant's recovery is dependent on the actions of a third party (i.e. in this case to demonstrate what would have happened had GT not been negligent), then loss of a chance principles must apply, rather than assessment of the probability third parties' actions having taken place by reference to 'the balance of probabilities' test. In other words, if causation depends at least in part on the action of one or more third parties, the claimant must demonstrate that there would have been *a real or substantial chance* that the third party would have acted in the respect relied upon by the claimant. In the present case, no reduction in quantum was required because Mr Justice Bryan was satisfied on the evidence that the relevant acts of the third parties would have occurred as AssetCo contended.

Secondly, prior to this this decision, there was no previous final judgment under English law on the topic of whether trading losses are recoverable when incurred as part of a pattern of dishonest behaviour by management of the Claimant. Mr Justice Bryan adopted a principled approach in answering this question and concluded on the facts that trading losses were recoverable because they were the result of the business being run in a fundamentally

dishonest fashion in reliance on GT's negligent audits (the detection of management dishonesty being intrinsic to an auditor's duties, so as to protect the company and its shareholders).

Thirdly, Mr Justice Bryan provides in his judgment detailed analysis of the principles applicable to mitigation and giving credit (the latter being the principle that the defendant may claim credit for the benefit of acts done or not done in mitigation by the Claimant to avoid loss resulting from the Defendant's breach of duty). This analysis is carried out in the light of the Supreme Court decision in *The New Flamenco [2017] 1 WLR 2581*.

Further proceedings

A further hearing is due to take place soon to determine the precise quantum of GT's liability, together with interest and costs. GT has also indicated it will seek permission to appeal.

For further information, please contact Georgina Squire or the Partner with whom you usually deal.