Mind the gap

by ***Christopher Smith QC***, **Essex Court Chambers**

Articles | Published on 06-Jun-2018 | England, Wales

Introduction
The facts
The litigation
The decisions
The issue
Considerations
Stage 1
Stage 2
Analysis
Conclusion

This article examines whether the combined effect of the decisions in *Tiuta International Ltd v De Villiers Surveyors Ltd [2017] UKSC 77* and *Swynson Ltd v Lowick Rose LLP [2017] UKSC 32* is that certain otherwise good claims would disappear into a legal black hole. The article also examines whether it might be possible to recover the relevant losses by advancing an alternative claim for loss of a chose in action.

Introduction

Readers will be familiar with the decisions of the Supreme Court in *Tiuta International Ltd (In Liquidation) v De Villiers Surveyors Ltd [2017] UKSC 77* and *Swynson Ltd v Lowick Rose LLP (In Liquidation) [2017] UKSC 32*. This article considers the possibility that the consequence of the two decisions, taken together, is that certain otherwise good claims would (to use a phrase first used by Lord Keith of Kinkel in *GUS Property Management Ltd v Littlewoods Mail Order Stores Ltd (1982) SLT 533* and referred to by Lord Browne-Wilkinson in *Linden Gardens Ltd v Lenesta Sludge Disposals Ltd [1994] 1 AC 85*) "disappear ... into some legal black hole so that the wrongdoer escaped scott-free".

© 2018 Thomson Reuters. All rights reserved.

The facts

The facts can be stated quite briefly, as *Tiuta* and *Swynson* have been considered respectively in Legal updates, *Supreme Court applies "but for" test to limit damages for negligent valuation* and *Court of Appeal wrong to apply principle of collateral benefit to allow party to recover damages for loss that had been avoided (Supreme Court)*.

In *Tiuta* the defendant valuers provided a valuation of a development property and the claimant provided a loan facility of up to £2,475,000 to the developer, secured on the property. Shortly before the facility was due to expire the developer sought further funding. The defendant provided a further valuation (which was in fact itself revised twice) and the claimant agreed to make additional funding available. Crucially, for the purposes of the subsequent litigation, this was achieved by way of a second facility agreement secured by way of a new charge. Most of the monies drawn down under the second facility were used to repay the whole amount advanced under the original facility, and the original charge was released. The second facility was never repaid.

In *Swynson* the claimant advanced money to its borrower, having retained the defendant to carry out due diligence on the borrower. The loan ran into difficulties and the claimant made two further advances. The borrower's situation did not improve and none of the money advanced was repaid. In due course the "wealthy investor", who controlled and was the beneficial owner of Swynson, made a separate advance to the borrower to enable it to repay the amounts outstanding under the first and second advances. That money was, as intended, used to repay Swynson, but neither the new loan nor the third of the original loans was repaid.

The litigation

In *Tiuta* the claimants sought to recover from the defendants the whole amount advanced under the second facility. Crucially, for the purposes of the subsequent litigation, the claimant did not allege that the original valuation was negligent. The claimant's case was that the second valuation was negligent. The defendants applied for summary judgment in relation to that part of the claim which equated to the sums advanced under the original facility, arguing that that money was already lost to the claimant before the second valuation was provided.

In *Swynson* the lender and the wealthy investor both sued the accountants who had carried out due diligence on the borrower. They sought to recover the full amount due under the third of the original loans and under the further loan, giving credit for recoveries that had been made. During the course of the trial the defendant conceded liability. As against the investor it argued that it owed no duty of care. The trial judge agreed and, there being no appeal against that conclusion, the main point that arose was that of quantum. In particular, the defendant argued that the first and second loans made by Swynson had been discharged and that the consequence of this was that Swynson had no claim in respect of those loans.

The decisions

The trial in *Swynson* took place before Rose J in May 2014. She gave judgment on 30 June and concluded that the advance made by the investor was *res inter alios acta*, meaning that Swynson was entitled to recover the full amount to which the defendant's liability had been capped by its terms.

© 2018 Thomson Reuters. All rights reserved.

The summary judgment application in *Tiuta* was heard by Mr. Timothy Fancourt QC on 20 March 2015. He gave judgment the same day, granting summary judgment in favour of the defendant in relation to that part of the claim equating to the original advance.

The appeal in *Swynson* was heard in May 2015 and judgment was handed down on 25 June. The appeal was dismissed, with the majority (Longmore and Sales LJJ) agreeing that the refinancing was *res inter alios acta*.

The appeal in *Tiuta* was heard in April 2016, with judgment handed down on 1 July. The appeal was allowed by a majority (Moore-Bick and King LJJ), who concluded that the deputy judge had failed to take into account the fact that the consequence of the structure adopted when the further advance was made was that the initial advance was repaid, meaning that no claim could arise in relation to the initial advance. The second advance was a wholly new transaction and loss fell to be assessed based on the amount advanced under the second facility.

The Supreme Court heard argument in *Swynson* in November 2016 and gave judgment on 11 April 2017. The appeal was allowed. The result was, therefore, that Swynson was not able to recover anything in respect of the first two loans which had in fact been repaid.

The Supreme Court heard argument in *Tiuta* on 6 November 2017 and gave judgment on 29 November. The appeal was allowed. The result was, therefore, that the lender's recoverable loss was limited to the new money advanced under the second facility.

The issue

Applying the ratio in both cases could potentially create an obviously unfair result. Specifically, if the valuers in *Tiuta* had in fact been negligent in relation to both valuations, and had been sued in relation to both valuations:

- The claim in relation to the first valuation would fail, because the loan advanced in reliance on the first valuation had been repaid in full (see *Swynson*).
- The claim in relation to the second valuation would arguably be limited to the additional amount advanced (see *Tiuta*).

In these circumstances the lender would be left without a remedy in relation to the vast majority of its unrecovered advances, even though the loss had been caused by the valuer's negligence. Is this the right outcome?

Considerations

In *Swynson* both Lord Sumption (at paragraph 16) and Lord Neuberger (at paragraph 104) referred to the transferred loss principle being "**driven by legal necessity**" to "**avoid a legal black hole**". It would, therefore, be surprising if the combined effect of the two decisions were in fact to create just such a black hole.

The question of whether it has done so is probably best answered in two stages. The first stage is to consider whether (on the facts suggested) the claim in relation to the initial advance really has been extinguished. The second is to consider whether the claim for the sums initially advanced can, in any circumstances, be included within the claim based on the second valuation.

© 2018 Thomson Reuters. All rights reserved.

Stage 1
The starting point for this part of the analysis must be the Court of Appeal decision in *Preferred Mortgages Ltd v Bradford & Bingley Estate Agencies Ltd [2002] EWCA Civ 336*. In *Preferred Mortgages* the claimant lent £49,500 based on what was assumed to be a negligent valuation. The claimant later made a further advance of £7,955.67 based on a valuation by a different valuer. The borrower defaulted and the claimant sued the original valuer. On the hearing of a preliminary issue the judge concluded, and the Court of Appeal agreed, that the second advance was made by way of "effective re-mortgage" by way of "redemption of the existing mortgage and grant of a fresh mortgage". On these facts it was held that there was no claim in respect of the first advance: it had been discharged in full.

In the Court of Appeal in *Tiuta*, counsel for the lender had relied on the *Preferred Mortgages* analysis in support of the proposition that, if the effect of the refinancing was to discharge the original loan, the claim in relation to the second valuation had to be for the full amount advanced pursuant to the second valuation. Counsel reserved the right to argue, in the alternative, that *Preferred Mortgages* was wrongly decided.

In the Supreme Court Lord Sumption observed (at paragraph 4) that it was common ground that there could be no liability in respect of the advances made under the first facility for two reasons: because "(i) there is no allegation of negligence in the making of the valuation on which the first facility agreement was based; and (ii) even if there had been, the advances made under that facility were discharged out of the advances under the second facility, leaving the lender with no recoverable loss". Lord Sumption observed that the second point was based on the decisions of the Court of Appeal in *Preferred Mortgages* and of the Supreme Court in *Swynson* and was not challenged on the appeal in *Tiuta*.

On the facts posited for the purposes of this article, it therefore appears to be beyond doubt that there can be no claim in relation to the original advance based on the original valuation. This would, moreover, appear to be the case even if the original valuer were different to the second valuer, as was the case in *Preferred Mortgages*.

Stage 2
In *Tiuta* Lord Sumption was clearly aware of the fact that, if the initial valuation had been negligent, a difficult issue would arise as to how the loss caused by this fact might be recovered. He pointed out that the cases are "**sensitive to the facts**" (*Tiuta, paragraph 15*) and remarked that "different considerations might arise were it to be alleged that the valuers were negligent in relation to both facilities". At paragraph 9 he observed that he "would agree that if the valuers had incurred a liability in respect of the first facility, the lender's loss in relation to the second facility might at least arguably include the loss attributable to the extinction of that liability which resulted from the refinancing". The question for those advising a lender in this situation is how strong this argument is.

In support of this argument one might point to what Lord Sumption said at paragraph 13. When analysing the proper application of what Lord Nichols referred to (in *Nykredit Mortgage Bank plc v Edward Erdman Group Ltd [1997] 1 WLR 1627*) as the "basic comparison", Lord Sumption's analysis was that the amount of the second facility used to repay the first facility was "**neutral**". This is because it increased the lender's exposure under the second facility by the same amount by which it reduced his exposure under the first. It made no difference to the net position when comparing "(a) what the plaintiff's position would have been if the defendant had fulfilled his duty of care and (b) the plaintiff's actual position" and was not recoverable. Lord Sumption did, however, specifically observe that "the

© 2018 Thomson Reuters. All rights reserved.

refinancing element might not have been neutral if the discharge of the indebtedness under the first facility had also extinguished a liability of the valuers under the first facility".

Analysis

Applying *Tiuta* it appears to be clear that the lender would not, on the facts posited, be entitled to advance a claim, as such, for the monies advanced to the borrower which were used to discharge the first loan. Can he, however, include within his claim "the loss attributable to the extinction of" the liability which existed in relation to the original valuation? Put another way can the lender, instead of claiming the money he has paid away to allow the original loan to be discharged, instead claim for the loss of his (valuable) chose in action?

Clearly the point is arguable, but I would respectfully suggest that there are a number of legal arguments and practical issues which make this a far from ideal solution. In particular:

- I see real issues as to whether it is foreseeable to the second valuer that part of the loan advanced in reliance on his valuation is used to extinguish an existing claim which the lender has. A valuer expects the lender to part with money, not to part with a chose in action.
- I see similar points arising as to whether it is within the scope of the valuer's duty to protect the lender from allowing an existing claim to be extinguished.
- Issues might also arise as to how the claim relating to extinction of the liability relating to the first valuation were to be assessed because, in reality, the lender has only lost the chance of pursuing a claim in relation to the original facility.
- This issue will be all the more difficult if either (or indeed both) valuers have enforceable limits of liability, or if either is in liquidation without the benefit of adequate liability insurance.

Conclusion

Applying the *Nykredit* basic comparison as it was applied in *Tiuta* it seems that, on the facts posited for the purposes of this article, the lender will not be able to advance, as such, a claim for that part of the monies actually lent which was used to discharge the initial loan. The lender may be able to advance a claim based on the fact that, as well as parting with the new money, he has lost the benefit of a valuable claim relating to the initial advance. Such a claim is, however, likely to be fraught with difficulties. The best advice may well be that lenders should ensure at the outset that they mind the gap which has now arisen. Any refinancing needs to be carefully structured so as to ensure that any pre-existing claim is not extinguished, because otherwise that claim is at risk of disappearing into a legal black hole.

END OF DOCUMENT

© 2018 Thomson Reuters. All rights reserved.