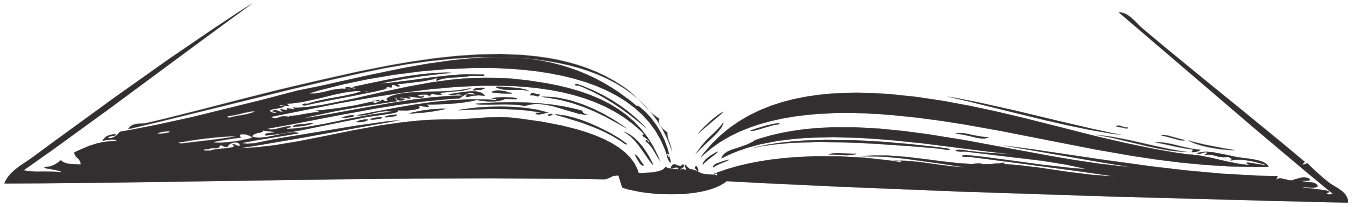
LEGAL

LEGAL NOTEBOOK



Recent cases, headline issues and new legislation by DLA Piper's **James Berg** and **James Morse.**

TIUTA INTERNATIONAL LTD V DE VILLIERS SURVEYORS LTD [2016] EWCA CIV 661

SNAPSHOT

In *Tiuta International Ltd v De Villiers Surveyors Ltd* [2016] EWCA Civ 661, the English Court of Appeal delivered an important judgment in favour of lenders in a valuer's negligence case, which has important consequences in terms of the proper assessment of damages in respect of certain transactions.

THE FACTS

In February 2011, Tiuta International Ltd (Tiuta) instructed De Villiers Surveyors Ltd (De Villiers) to value a partly completed residential development (Property) and prepare a valuation report. De Villiers valued the Property at £3.25 million in its then current state of development, and £4.9 million on completion. Tiuta relied on that valuation and advanced funds of around £2.56 million to its borrower, placing a legal charge over the Property as security for the loan (First Loan).

In November 2011, the borrower requested an increase in the loan facility to around £3.09 million. Tiuta instructed De Villiers to provide a new valuation report. De Villiers prepared two further reports, one in November 2011 (which was similar to the February 2011 valuation), and one in December 2011 which valued the Property at £3.5 million in its then current state of development, and £4.9 million on completion. In reliance upon the December 2011 valuation, Tiuta redeemed the First Loan and advanced the additional funds to the borrower (Second Loan).

Importantly, for the purposes of the application, it was assumed that the December 2011 valuation was negligent. It was also assumed Tiuta had provided the additional funds in respect of the Second Loan by refinancing the facility, rather than by simply varying the First Loan. The amount outstanding under the First Loan at the time of refinance was around £2.56 million, and it was assumed Tiuta opened a new account in favour of the developer in

respect of the Second Loan, advanced around £2.56 million to repay the amount outstanding under the First Loan, and further amounts from time to time as and when funds were drawn down by the developer. It was similarly assumed the parties entered into a fresh agreement in relation to the Second Loan, with the original charge in respect of the First Loan being released, and a new charge in respect of the Second Loan being executed and registered at the Land Registry.

On expiry of the term of the Second Loan, around £2.84 million remained outstanding. The loan was not repaid and Tiuta appointed receivers to enforce its security. The sale of the Property was expected to realise around £2.14 million, leaving a shortfall which Tiuta sought to recover from De Villiers on the basis it had negligently overstated the value of the Property in the December 2011 valuation. It was not part of Tiuta's case that the February 2011 valuation had been negligent.

De Villiers brought a summary judgment application before the High Court in relation to the issue of quantum, claiming that even if the December 2011 valuation was negligent, Tiuta could not have suffered a loss greater than the amount by which the indebtedness had increased between the First Loan and Second Loan (Top-Up Amount).

THE DECISION AT FIRST INSTANCE

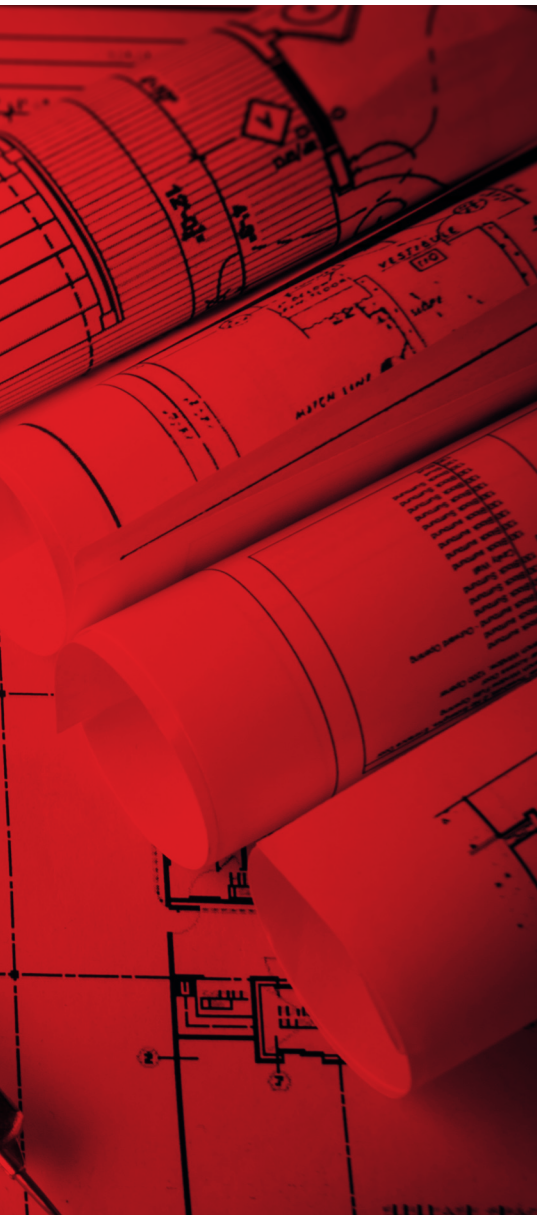
At first instance, the Court agreed with De Villiers.

In applying the "but for" test of causation, the Court found any negligence by De Villiers in relation to the December 2011 valuation had not caused the loss attributable to the First Loan. This was on the basis that, if the December 2011 valuation had not been negligent, Tiuta would still have been exposed to the (then) existing indebtedness as a result of the First Loan. As such, De Villiers was only liable for the Top-Up Amount, and not the total amount of the Second Loan.

The Court considered the earlier decision of *Preferred Mortgages Ltd v Bradford & Bingley Estate Agencies Ltd* [2002] EWCA Civ 336, where it was held a lender's claim against a valuer for a negligent valuation would be extinguished once the loan made in reliance upon the allegedly negligent valuation had been repaid. After considering that case, the trial judge stated:

"... In my view, there is nothing in the Preferred Mortgages decision that supports [Tiuta's] argument that causation should be decided on a different basis in such cases. The fact that no claim lies in respect of the first valuation does not make the application of the 'but for' test to the second valuation inappropriate or unfair. The claim in respect of the second valuation must stand or fall on its own merits ... There is no inconsistency between that approach and the decision

in Preferred Mortgages: all the money advanced to the borrower is treated as having been advanced under the new facility, which was made in reliance on the [December] valuation, and the existing loan was repaid out of the new advance. But did that cause [Tiuta] loss? The relevant comparison, for the purposes of determining factual causation of loss, is with the position in the no-negligence world. That was not an issue in Preferred Mortgages. If [De Villiers] had valued non-negligently, and so the second loan facility had not proceeded, [Tiuta] would have been exposed nonetheless to loss attributable to the existing indebtedness... I can see the force of the argument that a causation test that allows a defendant to take into account a claimant's existing exposure that it (the defendant) negligently caused, when it can no longer be sued for that negligence, is unattractive. But that argument would not apply where the existing exposure was not the defendant's fault, or in a case where — as here — no allegation is made that the first valuation was negligent ..."



THE COURT OF APPEAL'S DECISION

Tiuta appealed the first instance decision. By a majority of two to one, the appeal was upheld.

The majority

The majority found the trial judge had not correctly applied the "but for" test of causation given the particular circumstances of the case. The Court of Appeal looked closely at the nature of the transaction and the way in which the parties decided to structure their business transactions.

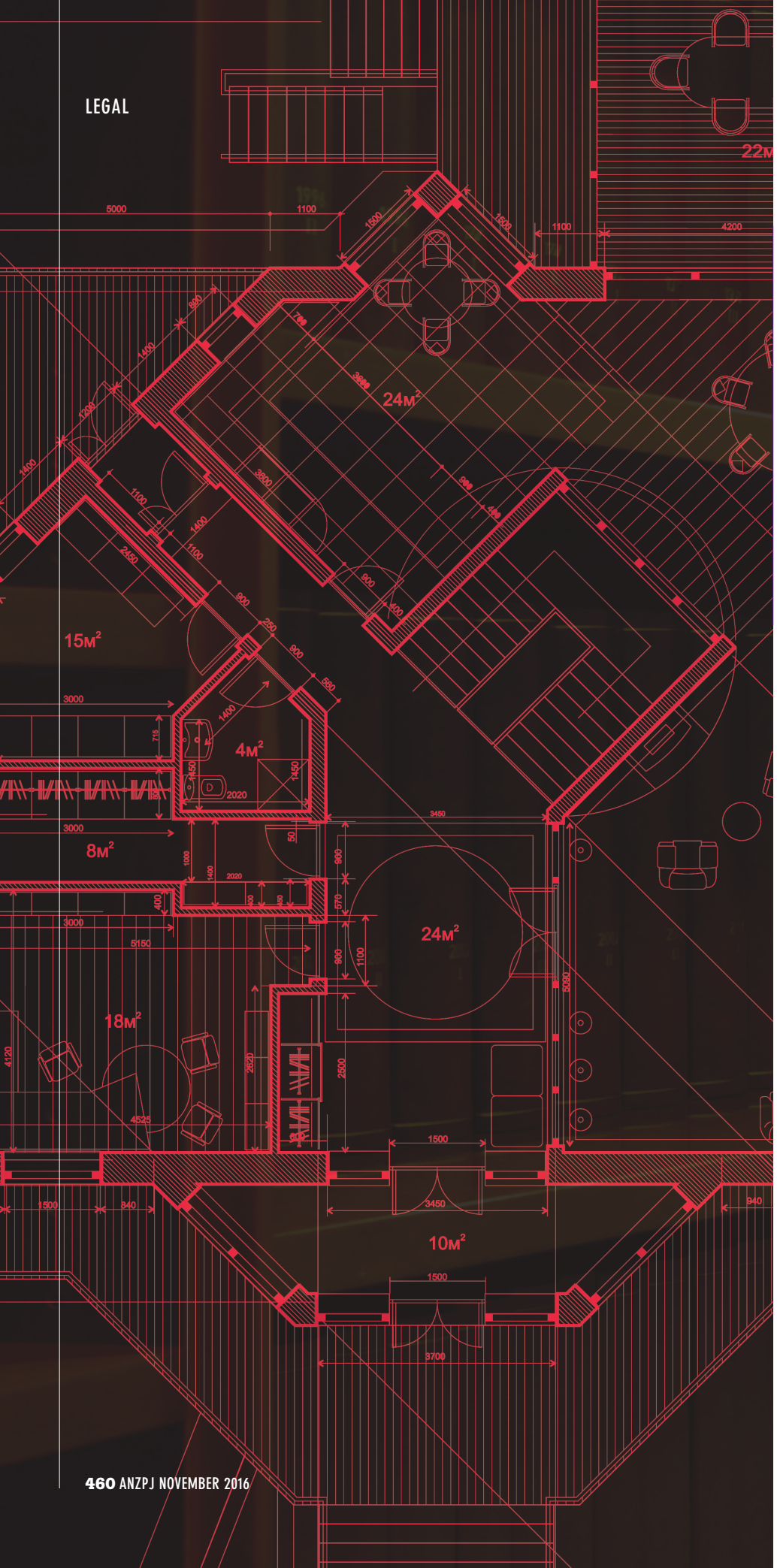
In focusing on the nature of the transaction, the majority held the purpose to which the Second Loan would be put was of no interest or relevance to De Villiers, and there was nothing unjust in holding De Villiers liable in accordance with its own valuation. De Villiers' role was to value the Property on which the loan funds were to be secured and, as such, it was liable for any adverse consequences flowing from Tiuta's entry into a transaction in reliance on the negligent valuation. Importantly, the majority held the lower court's application of the "but for" test had failed to take into account that one of the purposes of the Second Loan was to repay the First Loan, which also released De Villiers from any potential liability in respect of the February 2011 valuation.

On that basis, the loss was to be properly assessed by comparing the total of the Second Loan with the value of the security. This meant — on the basis the assumed facts were correct — De Villiers was properly liable for any shortfall between the amount outstanding on the Second Loan and the underlying value of the Property: not just the Top-Up Amount.

Lady Justice King, agreeing with Lord Justice Moore-Bick, noted:

"... it could be said to be inherently unfair that, where both parties are commercial organisations, a negligent valuer could use an attack on the legitimate working practices and systems of [Tiuta] as a means of escaping part of the consequences of his or her negligence. In the

IMPORTANTLY, THE MAJORITY HELD THE LOWER COURT'S APPLICATION OF THE "BUT FOR" TEST HAD FAILED TO TAKE INTO ACCOUNT THAT ONE OF THE PURPOSES OF THE SECOND LOAN WAS TO REPAY THE FIRST LOAN, WHICH ALSO RELEASED DE VILLIERS FROM ANY POTENTIAL LIABILITY IN RESPECT OF THE FEBRUARY 2011 VALUATION



same way as it is, and was, for [Tiuta] to organise its business affairs, so too was it for [De Villiers] to organise [its], namely to provide a valuation in respect of the [P]roperty as a whole in accordance with [its] instructions; having done so [it] did not seek to place any limitation on [its] potential exposure. On the contrary … [De Villiers] valued the [P]roperty in the expectation that [Tiuta] would advance funds up to its full reported value in reliance on its valuation …

I agree with Lord Justice Moore-Bick that there is nothing unjust in holding [De Villiers] liable in accordance with [its] own valuation, prepared specifically for the purposes of the [S]econd [Loan]. In my judgment absent any specific agreement to the contrary, it is irrelevant how [Tiuta] dealt with the money which it had advanced on the strength of the negligent valuation …

… The repayment of the [F]irst [L]oan and creation of an entirely new loan with fresh security and a new legal charge executed and registered at the Land Registry, had collateral consequences for both [Tiuta] and [De Villiers] which support the proposition that the [S]econd [Loan] stands apart from the [F]irst [L]oan. [Tiuta] was thereafter denied the opportunity to claim against [De Villiers] in relation to any alleged negligence in respect of the [F]irst [L]oan and equally [De Villiers was] … released from any potential liability in

respect of that first valuation. As a consequence, in my view the [S]econd [L]oan is entirely independent from the [F]irst [L]oan and it is in that context that the "but for" test should have been applied. Had the judge done so he would have concluded that, had there not been a negligent valuation, [Tiuta] would not have entertained the second transaction and [its] loss is the total advance of the [S]econd [L]oan less the developer's covenant and the true value of the security …"

Lady Justice King also noted De Villiers could have chosen to limit its exposure by negotiating terms and conditions to that effect when it accepted the instructions to value the Property, yet did not do so.

The minority

Notwithstanding the above, Lord Justice McCombe delivered a strong minority judgment, noting:

"… In so far as [Tiuta] 'lost' a potential claim in respect of the first valuation — a claim which it does not make in the proceedings at present — that result has been caused only by the way in which it chose to structure the second transaction. I can see no good reason to adjust the law of causation to avoid a problem of [Tiuta's] own making. There seems to me to be an inherent unfairness to [De Villiers] if the manner in which the new transaction was set up should enable [Tiuta] to saddle [De Villiers] with liability in respect of advances made long before the allegedly negligent valuation was provided and in respect of which it already stood to make a loss …

It seems to me that [Tiuta's] case requires one to ignore an important element of the factual background, namely that [Tiuta] was already in danger of being unable to recover the amount advanced on the [F]irst [L]oan at the time when it chose to make the [S]econd [Loan]…"

CONCLUSION

The case is an important decision in the lending space particularly in relation to the somewhat contentious issue of loss occasioned by an internally refinanced loan. Given the strong and competing views taken by the majority and minority, this is unlikely to be the last we will see of this issue.

The rationale taken by the majority is, however, still unlikely to apply to refinances between different lenders.

A key and current takeaway however for valuers is the importance of limitation of liability clauses, including in the situation where their valuation may be relied upon by a lender to extinguish existing loans and make a new loan. At least for now, such limitation of liability clauses may be the best way to reduce or remove potential exposure which may otherwise exist in respect of allegedly negligent valuations completed for the purposes of internal-refinances.

AUTHORS' NOTE

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