"SURVEYORS' LIABILITY" A REVIEW OF RECENT CASE LAW

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In recent years, valuers and surveyors have reeled under an onslaught of claims from lending institutions which have sought to recover huge losses sustained in what is widely regarded as the deepest property recession for a generation. Indeed, it was recently reported that professional indemnity claims against valuers since 1990 have reached the astronomical amount of £1 billion.

Many claims have reached the courts, resulting in a rapidly developing body of caselaw. At the time of writing, the latest decision is that in *Banque Bruxelles Lambert SA -v- Eagle Star and Others (1993)* which, as far as I am aware, represented the largest ever UK professional indemnity claim against a firm of valuers.

The time would therefore appear to be ripe to cast an eye back over recent decisions and to consider whether surveyors and their insurers may glean any crumbs of comfort.

WHEN IS A VALUER NEGLIGENT?

The traditional test to assess whether a valuation was negligent was whether it fell outside **a 10% margin of error** either side of the **"correct"** valuation and that, in exceptional circumstances, the permissible margin might be increased to 15% or a little more *(Singer & Friedlander -v- John D Wood (1977))*. This approach has been relaxed somewhat in recent decisions, such as *Mount Banking Corporation -v- Brian Cooper & Co (1922)*, where the test used was whether the particular valuation fell within the ***range*** of valuations which a reasonably competent valuer could have determined, recognising that, where many assumptions had to be built into a valuation, this could produce a wide range of values the existence of which would not necessarily connote negligence. A similar approach was adopted in *Macey -v- Debenham Tewson & Chinnocks (1992)* and this appeared to herald a more sophisticated approach by the courts to commercial valuations acknowledging that competent valuers could reach very different opinions on the value of the same property.

From recent decisions, it is possible to detect some reluctance by the courts to impose liability upon surveyors. A good example is the case of *PK Finans International (UK) Limited -v- Andrew Downs & Co (1992)*. The plaintiff lender

brought proceedings against the defendant firm of surveyors, alleging negligent preparation of a valuation report. It was contended that the defendant should have warned that it would be necessary to verify the existence of certain planning permissions which the developer claimed had been obtained. The plaintiff relied upon the RICS Guidance Notes which provided that the valuer should in most, if not all, cases make it clear that such verification is required. The court held that a mere failure to comply with the Guidance Notes did not necessarily constitutes negligence. Different approaches were appropriate for different clients. The plaintiff was a large financial institution which should not have contemplated making a large loan without verifying the existence of planning consents which affected the valuation of the property.

The defendant surveyor also avoided liability in the case of *Private Bank & Trust Co Limited -v- Sallmans (UK) Limited (1993),* which concerned residual valuations of a property undertaken in April and June 1990. It was held that the court had to determine the knowledge and skill available to a valuer at the time of the valuation and had to be careful to guard against hindsight. Although by June 1990 the market had slowed down, on the information then available, no-one could have predicted the decline which followed in the second half of the year. The fact that the country was heading for a recession, with a catastrophic effect on development sites, was not reasonably foreseeable and therefore it was held that the defendant's valuation was not negligent.

A further interesting decision was that in *Craneheath Securities Limited -v- York Montague LImited (1993).* The judge stated the the traditional test in *Singer & Friedlander* was only appropriate where there were a number of comparables available, for example, houses on an estate. This test was not, however, appropriate for the particular property in question (a restaurant complex), where there was no evidence to indicate what would be an acceptable margin of error. The judge therefore adopted the test in *Mount Banking* and assessed whether the valuation was that which a competent valuer, exercising proper skill and care, could properly have reached.

The defendant's valuation was in the sum of £5.25 million in September 1989 and the property was eventually sold at auction in May 1992 for £475,000. The plaintiff's expert valuer made a retrospective valuation of only£2 million. Even the defendant's expert only gave a retrospective valuation of £3.76 million and was not called to give evidence. It was held, however, that these figures did not constitute a

prima facie case of negligence and that the methodology adopted by the defendant was satisfactory.

The plaintiff also argued that the defendant did not verify the figures, for example, as to turnover, which were used in calculating the valuation. However, the defendant's valuation report expressly stated that no accounts had been seen and that reliance had been placed upon information received from the directors of the company which owned the property. On this basis, the judge stated that it was difficult to see why the defendant had been negligent.
Although this particular decision is now subject to appeal, it does reflect the reluctance of the courts, at least at first instance, to find surveyors negligent in respect of commercial valuations relied upon by lending institutions.

The judgment in *Banque Bruxelles Lambert SA -v- Eagle Star and Other (1993)* represented the culmination of extremely lengthy and complex litigation which, as a result of various settlements agreed during the course of the trial, eventually boiled down to a straightforward claim against John D Wood, alleging negligent over-valuations in respect of three properties. Damages were awarded in favour of the plaintiff bank in respect of two of the properties amounting to to approximately £10.8 million.

The judge, however, adopted a somewhat different approach in finding that John D Wood had been negligent. The facts of the case are extremely complex but, for present purposes, it is sufficient to note that the plaintiff bank had lent very considerable sums on the security of a number of commercial properties. The bank was prepared to advance 90% of the value of each property, provided they contained 100% mortgage indemnity cover from the first defendant, Eagle Star. The amount of the loan, and of the cover, thus depended upon the value of the properties. Certain of the properties were valued by John D Wood at amounts substantially exceeding the recent purchase price of each property.

The judge found that John D Wood's valuations in respect of two properties had been negligent. In so doing, he placed particular emphasis on the recent purchase price as being the best indication of the open market value. The judge did not follow the test in *Mount Banking* and rejected the approach of John D Wood's expert in considering a range of non-negligent valuations.

The judge stressed that what was important was assessing whether each property

had been properly marketed at the time of sale and as consideration of comparable properties was relegated to being merely a cross-check of the validity of the purchase price.

The judge therefore reverted back to the traditional test of assessing the "correct" valuation, but went on to indicate what he regarded as being the maximum value which could have been placed on each property by a reasonably competent valuer. The result what that, on the facts, the permissible margin of error was very narrow indeed: around 9.1% and 6.7% respectively for the properties in question.

It remains to be seen whether this rather restrictive approach is adopted in future decisions. Recent caselaw has shown the courts' reluctance to lay down rigorous tests in assessing liability; indeed, in the *Mount Banking* decision, the surveyor was found not to be negligent, although the valuation was approximately 20% in excess of the purchase price.

HOW ARE DAMAGES ASSESSED?

Where a lending institution would have lent nothing with a competent valuation, the leading authority is the House of Lords' decision in *Swingcastle Limited -v- Alastair Gibson (1991)*.The lender's damages will be measures by comparing what would have occurred, but for the valuer's negligence, and what actually happened. Thus, the usual measure of loss would be the difference between the loan facility and any sale proceeds of the property, plus expenses and interest, credit being given for any repayments of capital or interest payments by the borrower.

This approach was not followed in the *Banque Bruxelles* decision. Although it was held, on the facts. that the plaintiff bank would not have granted any loan facilities had the valuation been competent, nevertheless the judge ruled that *John D Wood could not be held liable for that part of the bank's loss attributable to the collapse of the property market.* The judge did not consider that this part of the loss could be said fairly and reasonably to have resulted naturally from John D Wood's breach of duty. On the facts, the bank did not rely upon John D Wood's valuations to protect them against a fall in the market. The transactions were founded upon a belief that the property market was rising and would continue to rise. They represented an attempt to share in the profits which the property companies were making and, in so doing, they involved an assumption of risk that the market movement might be reversed.

In respect of each property, the judge therefore deducted the difference between the correct valuation at the relevant time and the value as at the date of assessment of damages. In the case of the two properties in question, this reduced the quantum of the damages awarded by £7.5 million and £34.75 million respectively!

On the face of it, this approach appears to "answer the prayers" of surveyors and their insurers. The decision should certainly be relied upon in settlement negotiations in future claims. However, the approach adopted by the judge does not perhaps sit very easily with the decision in *Swingcastle* where the underlying concept appears to have been that damages should be assessed on the basis that the lenders were entitled to be placed in the position that they would have been in if they had received a competent valuation and had consequently made no loan to the borrowers.

Furthermore, the judge in *Banque Bruxelles* took pains to indicate that he was not laying down any new legal principle and that his findings were confined to the facts of the particular case.

I should add that the issue as to whether any discount should be made to damages on account of the collapse of the property market was also considered by Mr Justice Gage in *United Bank of Kuwait -v- Prudential Property Services Ltd* (10th December, 1993). Although the argument was put on a slightly different basis, the Judge declined to make any deduction and considered himself bound by the 1939 Court of Appeal authority of *Baxter -v- Gapp*. While that decision was described by the House of Lords in Swingcastle as an unattractive precedent, it was not specifically over-ruled on the question of the measure of damages. For his part, Mr Justice Phillips held in Banque Bruxelles that:

> "I do not consider that *Baxter -v- Gapp* can any longer be relied upon as governing the principles to be applied to the assessment of damages in a case such as this".

It therefore remains to be seen as to which approach the Courts will adopt in the future, although I can confirm that Cameron Markby Hewitt are appealing the decision in *United Bank of Kuwait* on behalf of Prudential Property Services Ltd.

Despite the above words of caution, *Banque Bruxelles* nevertheless represents authority for discounting what is often a very significant part of a lender's loss and, as regards the many claims "in the pipeline", will no doubt be relied upon in set-

tlement renegotiations. Although this case was not concerned with the situation where a lender would have lent a lesser amount had a competent valuation been received, there would appear to be no good reason why a similar deduction should not be made in this type of case as well. Nor is there an apparent reason why it should not be equally applicable to residential valuations.

CONTRIBUTORY NEGLIGENCE

Traditionally, the courts have been very reluctant to entertain allegations of contributory negligence in relation to commercial valuations. However, during the boom period of the property market, lenders often lent imprudently and many were virtually "throwing money" at the property market in the hope of sharing in the massive profits being generated by the property companies.

In the *PK Finans* decision referred to above, the judge stated that, even if the plaintiff had established negligence, the plaintiff's failure to forward the valuation to their solicitors (which would have led to the relevant planning permissions being checked) amounted to contributory negligence which would have reduced the plaintiff's damages by 80%.

Similarly, in the *Craneheath* case, the judge indicated that a finding of contributory negligence might well be made where a lender sought to rely on a valuation when in possession of relevant information affecting the valuation which had not been passed to the surveyor for comment.

However, *Banque Bruxelles* represents the watershed decision on contributory negligence in surveyors' claims. In that case, the judge indicated that the conduct of the plaintiff had to be judged against the standards of a reasonably competent merchant bank at the time. In each of the relevant transactions, the bank loaned very substantially more than the sale price. Moreover, the developers were not injecting any cash and, indeed, were often able to take immediate profits. It was held that this did not, in itself, mean that the transactions were necessarily commercially imprudent, but that it underlined the necessity of subjecting the transactions to careful analysis.
The key point stressed by the judge, however, was that the open market valuation of each of the properties concerned was vastly in excess of the prices that were being paid for those properties. A prudent bank would have sought an explanation for the disparity in each case before relying on the property as the sole source of repayment of the loan. A second opinion from a competent valuer would have

shown the bank that John D Wood's Valuations were unsound.
The judge was also critical of the bank's lack of contact with the developers; it should have asked how it was that the developers could pay so much less than the market value. The judge commented:

> "I believe that (the plaintiff) was swept along by the general euphoria generated by the boom in the property market. Property companies were making huge profits and the important thing was to get a share of the action".

In summary, the judge ruled that the bank had been contributory negligent and awarded a 30% reduction in damages.

In the light of *Banque Bruxelles*, we are likely to see in future far more allegations of contributory negligence being pleaded. The banks and financial institutions will always be sensitive to this type of allegation; this decision will bring home to then that, in future, their lending practices are likely to come increasingly under the spotlight.

CONCLUSION

I believe that the above review of recent caselaw shows that the position of valuers is not as bad as might have been feared when the property market crashed. The courts have, in general, been reluctant to make any finding of liability. Although the recent *Banque Bruxelles* decision indicates a tougher approach towards assessing negligence, it also provides some authority for the view that surveyors should not be held responsible for losses arising from the collapse of the property market. It also demonstrates that a claim for contributory negligence can succeed against a plaintiff lender and may, indeed, lead to a considerable reduction in the overall award of damages.

In short, surveyors and their insurers can defend claims "in the pipeline" in the knowledge that surveyors have not, as many feared, been found to be the scapegoats of the property recession.