

Valuers' Update

WINDSOR
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In this uncertain period for valuers and surveyors generally, we try to keep you up to date with important developments, both legally and within the insurance market. Within this Newsletter are three recent developments which may affect, both positively and negatively, those within this area.

PARATUS AMC LIMITED v COUNTRYWIDE SURVEYORS LIMITED

This case is important for property valuers and their Insurers as it gives some much needed guidance from the Courts about how they intend to view valuers' liability, in particular with regard to the level of fee charged for the work and the behaviour of the lender themselves in deciding whether to lend or not in the first place.

The following text has been provided with the kind permission of lawyers Clyde & Co:

Background

In July 2004, Mr Stockton (Mr S) sought to re-mortgage a property at Fulford Place, York. He made a mortgage application through his broker to the claimant (formerly GMAC RFC Limited). In the mortgage application, Mr S stated that the property was worth £185,000 and he requested a ten year, interest only, mortgage of £166,500 (the loan to value ratio being 90 per cent). The first claimant instructed the defendant (who was on its panel of valuers) to value the property. In late July the defendant inspected the property and confirmed that it was suitable security and the market value was £185,000. In reliance on the valuation the re-mortgage completed. The beneficial interest in the re-mortgage was sold to the second claimant in March 2005 as part of a package of loans (the Securitisation). The legal interest remained vested in the first claimant who remained the mortgagee. In late summer 2007 Mr S defaulted on his repayments. The first claimant subsequently obtained possession of the property which was sold in September 2008 for £123,500. The net proceeds of sale were £118,103.20.

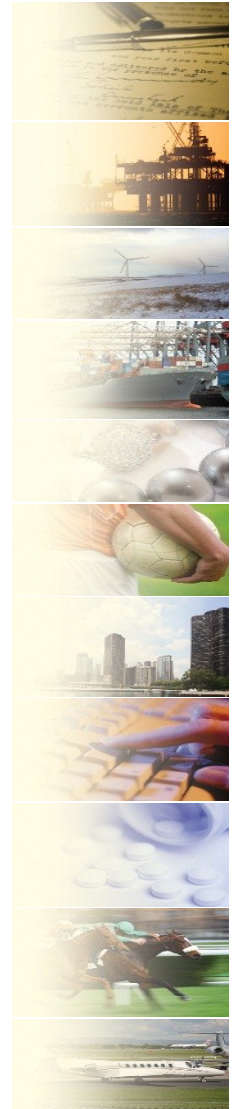
The claimants brought a claim against the defendant to recover its loss. In the claim the claimants' expert valued the property at July 2004 in the region of £154,000. The defendant's expert valued the property at £175,000 and argued that the valuation was within the acceptable range of values.

Was the valuation negligent?

It was common ground that the key question in determining negligence was if the defendant's original valuation fell within the range of values that a reasonably competent valuer exercising reasonable skill and care could have arrived at. To determine if the valuation was negligent the Court would need to establish a) the market value of the property, b) the range of acceptable values and, c) if the valuation fell within the acceptable range.

What was the value of the property in July 2004?

The Court heard evidence from both parties' experts to determine the actual market value of the property in July 2004. Each expert's approach differed. In summary, the Court rejected the claimants' expert's valuation method, which was based primarily on the application of a price per square metre to the floor area of the property. Instead, the Court preferred the defendant's expert's approach. This approach used comparable sales evidence obtained from the Land Registry for the period immediately prior to the valuation. Accepting the evidence of the defendant's expert, the Court concluded that the market value at July 2004 was £175,000.



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What was the acceptable range of values?

The Court then turned to consider the acceptable range of values. The claimants' expert sought to argue that the correct range would be plus or minus 4 per cent. The defendant's expert argued in favour of a permissible range which worked out at 11.4 per cent. The Court commented that the margin could not be regarded as a matter of law and also approved the defendant's expert's approach of not starting with a percentage. However, the Court considered that his suggested range was too high. Instead the Court used its own discretion and applied an acceptable range of £160,000 to £190,000 which equated to an 8 per cent margin.

Was the valuation negligent?

As the original valuation of £185,000 fell within the range of £160,000 to £190,000 the Court did not find that the valuation was negligent. The Court ordered that the claim be dismissed.

The scope of duty

In reaching its conclusions the Court had to consider the correct approach to the valuation. There was some discussion of the scope of the enquiries which the valuer should have made. It was suggested that the valuer could have sought details of the floor area of the comparable properties, and confirmation if any incentive (such as a reduction in the purchase price) was given by the developers.

In considering this issue, the Court had regard to the valuer's level of remuneration. It commented that where the valuer is paid a low level of remuneration "the fee sets some parameters to what is reasonably to be expected".

In the context of this decision, it was found that the valuer was not required "to make enquiries of developers who have completed their developments and moved on" and as to the investigation of floor areas this "would in my view only be credible if values correlated with areas". The implication from this finding is that the scope of a valuer's duty is likely to depend on the nature of the retainer and remuneration. It is not clear what impact this will have on future decisions and it will be interesting to see if this finding is extended beyond these specific facts given the modest fees paid for mortgage valuations.

Claimants' right to recover loss and contributory negligence

Despite dismissing the claim, having heard evidence from both parties' experts, the Court went on to comment in relation to two other key points.

Did the securitisation prevent the claimant from pursuing the claim

The defendant argued that the duty was owed to the first claimant and that the Securitisation had assigned the first claimant's cause of action against the defendant to the second claimant. Further, it was argued that the first claimant had suffered no loss as the losses had been borne by new holders of the security following the Securitisation. On the facts the Court held that the assignment had not taken place. It also found that the income from the securitised mortgages was distributed between various parties and the first claimant was the residual beneficiary. As such, the Court found that it had suffered loss. In any event, the judge went on to conclude that the defendant was seeking to exploit the consequences "of a strict application of the technical rules concerning assignment to a widely used financing technique" and that it "would be a sorry state of affairs if.....losses for which a negligent valuer would otherwise have been liable become irrecoverable".

Contributory negligence

As much of the evidence had been heard, the Court felt competent to comment in relation to the contributory negligence arguments.

The Court declared that it would not be imprudent for the claimant to agree to a mortgage with a loan to value ratio of 90 per cent per se, rather that it would depend on all the circumstances. In particular, where a high loan to value is agreed the claimants were under a duty to investigate and verify matters of central importance to the mortgage, such as Mr S's financial position. At trial it was found that Mr S provided information as to his income and liabilities which was misleading. The claimants sought to argue that the honesty of the borrower was not critical if he had the ability to keep up payments. However, the Court considered that when these discrepancies were taken into account with other factors, it would lead the claimant to the conclusion that Mr S was dishonest and that it would not have lent to him.

On the facts, the Court found that the claimant had contributed to its own loss. Had the valuation been negligent, a reduction of 60 per cent to the claimants' entire loss would have been made.

Practical implications

This case should provide some comfort to valuers. Although it does not excuse a negligent valuation, it does suggest that a court will more readily interpret the valuation exercise by having regard to the level of fees paid.

Further, where valuations are found to be outside the acceptable range, valuers will be pleased to hear that courts are still willing to hold lenders to account for their imprudent or careless lending.

"Hopefully, this case will provide some comfort to valuers and their insurers that, in certain circumstances, the courts will look favourably on the limited role valuers had in the whole lending decision."

Marcus Elwes
Partner

MITCHELL MORGAN NOMINEES PTY LIMITED V VELLA & ORS

On the 15 December 2001 the NSW Court of Appeal (5 Judges – unanimous) delivered a judgment in *Mitchell Morgan Nominees Pty Limited v Vella & Ors* which has, potentially, significant ramifications for proportionate liability defences.

Vella involved a lender's claim against a firm of solicitors who had prepared a mortgage which did not protect the lender from the fraud of third parties. The decision in the first instance was a very helpful one in terms of proportionate liability defences, because fraudster parties were found to have an overall liability of 87.5%, whilst the "innocently" negligent defendant was apportioned 12.5% of the loss. Since that initial judgment, defendants have had some considerable success in resolving matters at mediation etc with a significant reduction by reason of the conduct of borrowers or other parties who engaged in misleading and deceptive conduct.

"Vella may end up in the High Court. If not, with the proposed Draft Model Proportionate Liability Provisions which may be enacted in 2012 and the suggested definition of concurrent wrongdoer there may be some relief from the Vella judgment."

Robert Turner
Partner - Claims

However, in Victoria, the Victorian Court of Appeal decided a matter of *St George Bank v Quinnerts* in which it was held, essentially, that:

For there to be a concurrent wrongdoer, the wrongdoing must pertain to the *same* loss or damage:

- In the context of a valuer's negligence claim (Quinnerts) and the failure by the borrower to repay the loan, the losses were not the same because:
- The loss caused by the valuer was occasioned by the lender having inadequate security to recover;
- The loss caused by the borrower was occasioned by a failure to repay the loan.

It should, however, be noted that the borrower in Quinnerts did not mislead or deceive the bank.

The Court of Appeal in *Vella* endorsed the decision in Quinnerts and focused specifically on the issue of *same loss or damage*. In citing Quinnerts, the Court of Appeal said the following:

"...the loss the subject of the bank's claims against the borrower and guarantor was their failure to repay the loan, the loss the subject of the bank's claim against the solicitor was absence of adequate security, and they were different losses.

...the different interests of repayment by the borrower or guarantor and holding adequate security..."

The Court of Appeal upheld the appeal and found that the fraudster parties were not concurrent wrongdoers as their wrongdoing did not cause the *same* loss or damage. As such, the "innocently" negligent party wore 100% of the liability.

It is important to highlight this development, given the magnitude of its impact in a number of claims being currently conducted, both in respect of valuation claims and other professional indemnity claims.

With thanks to DLA Piper Australia for alerting us to this.

SPINNAKA - UPDATE

Until December 2010, Spinnaka was in the business of sourcing valuations on behalf of its lender, packager and broker client base. Known in the insurance market as a panel manager, the business essentially managed the process for the return of valuations to the client using property data systems, Quest and xit2. It received a proportion of the valuation fees for administering the process.

Recent press articles say the company ceased trading because it could not obtain Professional Indemnity Insurance (PII) and so went into administration in December 2010. The administrators have since sold the assets and goodwill to Pure Panel Management Ltd and the business model is identical.

Spinnaka insured for its last year of trading 100% with one leading London Market insurance company. The policy was understood to be an overarching policy whereby it would only be called upon in the event the valuers to whom the instructions were panelled had no PII or inadequate PII to meet any claims.

From our own experience of Spinnaka's panel firms, the contracts that there were between the company and the valuers did not adequately regularise the PII position in the event a complaint or claim was made. Nevertheless, even in the absence of an enforceable written contract, the valuers seemed to have accepted that they assumed responsibility for the losses arising directly from their mortgage valuation reports.

The way the xit2 and Quest systems operated meant that valuers could upload their reports on the lender's standard forms and meet the fast turn around required. The valuers would sign off the reports in their personal names and would then add the company name of

Spinnaka Ltd followed by their own local trading addresses. To the recipients of the reports, the valuations were performed by Spinnaka and it is unlikely (we believe) that the valuer may have even had knowledge of the identity of the lender at the date of reporting.

In the lead up to the administration, we understand that lenders wrote to Spinnaka and scheduled thousands of transactions they considered they might suffer a loss on (account in arrears etc) and sought to benefit from Spinnaka's 2010 policy to the extent that a claim did, in the future, need to be made. Spinnaka passed these to the insurer who immediately reserved their rights and instructed a leading firm of lawyers to investigate.

Pending the outcome of the investigations by lawyers, the insurer agreed with the core lenders a 12 month moratorium, whereby the lenders would not advance any claims and the PII position could be investigated and costs not wasted.

The moratorium is about to expire and the insurance issues are still not resolved and this prompted Spinnaka's insurer to write to the panel firms - the first batch having been sent out the first week in December 2011. The letters do not explain the status of any claim on any of the valuation transactions or when any claim or potential claim was intimated. We assume that Spinnaka's insurer has spent some considerable time correlating records, to ascertain which panel firm received instructions etc. Over 70 letters are believed to have been written by the insurer to the panel firms they know are still in existence. Firms may receive more than one letter as more records are provided by the administrators.

We are led to believe that all the transactions listed are cases where Spinnaka received Preliminary Notices (as opposed to formal claims). We also understand that the moratorium did not extend to limitation, so there may be some issues ahead.

It follows that the firms in receipt of letters are being asked to assume responsibility for potential losses arising from their valuations. Spinnaka's insurer has been assessing the risks of claims and losses on those transactions where there may be no other PII policy to call upon (perhaps where the panel firm no longer exists etc). Their actions may affect how lenders view any direct actions against the panel firms and, of course, how the insurers themselves pursue for claims payments they decide they may or may not have to make.

Depending on how this matter develops, availability of insurance for and lenders' attitude towards Panel Managers may be affected going forward. The same could be said for those independent firms who are or have been providing services via a panel manager. For those former panel firms of Spinnaka, how their own insurers react to these possible notifications and Preliminary Notices could be a concern, especially if a change of insurer or indeed a renewal has taken place in the meantime. A firm looking for a new insurer may also find themselves caught between old and new insurers with different views on who should be covering any subsequent claims that may arise.

Chris Wright - Senior Partner

Windsor Partners Limited's specialist surveyors and property consultants team are available to discuss any concerns you may have about issues raised in this Newsletter or any other matter

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