Case No: A10CL339

IN THE COUNTY COURT AT CENTRAL LONDON

Thomas More Building
Royal Courts of Justice, Strand, London, WC2 2LL

Date: 17/09/2015

Before :

RECORDER D HALPERN QC

- -

Between :

CANADA SQUARE OPERATIONS LIMITED	**Claimant**
- and -	
KINLEIGH FOLKARD & HAYWARD LIMITED	**Defendant**

- -
- -

Mr Peter de Verneuil Smith (instructed by **Rosling King LLP**) for the **Claimant**
Mr Jamie Carpenter (instructed by **Hill Dickinson LLP**) for the **Defendant**

Hearing dates: 7th to 9th September 2015

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

....

RECORDER D HALPERN QC

Mr D Halpern QC :

1. This is the judgment following the trial of a claim for damages for professional negligence by a lender against a valuer. The original lender was Future Mortgages Ltd but it assigned its cause of action to the current claimant, who was substituted by order of 31st July 2015. I shall use the term "Lender" to mean the original lender in respect of the period before assignment and the current claimant in respect of the period thereafter. The defendant ("the Valuer") admits that it negligently overvalued the property. The issues which remain to be decided are limitation, reliance and quantum.

The facts

2. The basic facts are largely agreed and may be stated shortly.

3. Mr Slee and his wife ("the Borrowers") were the owners of Braypool House, Braypool Lane, Brighton BN1 8ZH ("the Property"), subject to a mortgage. Mr Slee was a builder and was in the course of building a house on the Property. The Borrowers wished to obtain further funds by remortgaging the Property.

4. On 20th November 2005 the Borrowers applied to the Lender for an interest-only mortgage loan in a sum equal to 90% of the value of the Property, which they said was £500,000. Mr Slee self-certified his income as being £165,000 a year derived from his building company Sussex County Property Ltd ("SCP"); his wife said that she had no income. They listed their existing commitments as including an unsecured loan from Mint with a monthly repayment of £215 and a secured loan from Amber with a monthly repayment of £894.

5. On 23rd December 2005 Connells Survey and Valuation Ltd ("Connells") provided the Lender with a written valuation of the Property in the sum of £475,000. Under the heading "Essential Repairs and/or Retentions" it said:

> "Although substantially complete, completion to building regulation certification standard is still outstanding for minor electrical works which should be completed within a reasonable period (3 months) subject to an undertaking by the applicant."

Under the heading "General Remarks" it said:

> "Well proportioned and presented new build detached house close to completion.
>
> …
>
> Our valuation of the completed property assumes that construction will be in accordance with approved Planning, Building Regulations and NHBC (or similar approved) requirements."

6. On 25th January 2006 the Valuer provided the Lender with a written valuation in the sum of £500,000. This valuation is the subject matter of these proceedings. It confirmed that

the Property was suitable security for mortgage purposes. Nothing was listed under "Essential Repairs and/or Retentions". Under the heading "General Remarks" it said:

> "The subject is a well-presented detached house newly constructed under self-build scheme although has the benefit of NHBC guarantee. Conveyancer should confirm this and ensure all normal consents and approvals have been obtained and complied with."

7. On 13th February 2006 the Lender sent a fax to Connells saying:

> "Please note that another valuation has been carried out as part of out [presumably 'our'] policy. This valuation has given a different current market value to the one advised by you [;] however the comparables given on your report are were [*sic*] sold over 6 months ago. It has been valued at £500k and the comparables given by this valuer are within date. Please could you review the attached valuation report and advise if your figure has been reviewed or remains unaffected."

Connells replied on the same day saying that the properties referred to by the Valuer were not comparable and that its valuation remained unaffected. (One of the principal issues in the case is why there were two valuations and whether the Lender relied on the one in dispute.)

8. On 27th February 2006 the Lender made its formal offer to lend £427,500 on the basis that this represented 90% of the Property which was valued at £475,000. The offer was subject to various conditions, including a requirement that the Borrowers repay various loans totalling £87,013.

9. On 16th March 2006 the Lender advanced £428,791.36 (inclusive of associated fees and costs) by way of an interest-only mortgage at a rate linked to LIBOR.

10. The Borrowers duly paid monthly instalments by direct debit until January 2007. Thereafter some payments were made by debit card during 2007 and the last payment was made in January 2008. (The payment history is relevant to the question of limitation and will be considered further below.)

11. On 29th August 2008 the Borrowers voluntarily surrendered possession of the Property to the Lender. The Property failed to sell at auction but was eventually sold in May 2009 and transferred on 8th July 2009 for £305,000. The purchaser's solicitors discovered that it was subject to a right of way. This had not been noticed by either of the valuers or by the solicitors acting on the mortgage. However, no complaint is made against the Valuer in this regard.

12. Mr Slee and Ms Egeler were adjudicated bankrupt on 28th September 2008 and 24th August 2009 respectively.

13. On 23rd October 2013 the Claim Form was issued.

Limitation

14. The Lender does not pursue its claim in contract, which is plainly statute-barred. The issue between the parties is whether the cause of action in tort arose before 23rd October 2007. This depends on whether the Lender first suffered measurable relevant loss before that date.

15. Before turning to the facts, I must consider four issues of law:

    15.1 What is meant by measurable relevant loss?

    15.2 On whom is the burden of proof?

    15.3 Should the court take account of facts existing at the relevant date which were unknown to the parties at that date?

    15.4 Should the court make use of hindsight?

Measurable relevant loss

16. In *Nykredit Mortgage Bank Plc v Edward Erdman Group Ltd (No 2)* [1997] 1 WLR 1627 at 1631D-1632C[1], Lord Nicholls said:

> "When, then, does the lender first sustain measurable, relevant loss? The first step in answering this question is to identify the relevant measure of loss. It is axiomatic that in assessing loss caused by the defendant's negligence the basic measure is the comparison between (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. Frequently, but not always, the plaintiff would not have entered into the relevant transaction had the defendant fulfilled his duty of care and advised the plaintiff, for instance, of the true value of the property. When this is so, a professional negligence claim calls for a comparison between the plaintiff's position had he not entered into the transaction in question and his position under the transaction. That is the basic comparison. Thus, typically in the case of a negligent valuation of an intended loan security, the basic comparison called for is between (a) the amount of money lent by the plaintiff, which he would still have had in the absence of the loan transaction, plus interest at a proper rate, and (b) the value of the rights acquired, namely the borrower's covenant and the true value of the overvalued property.
>
> However, for the reasons spelled out by my noble and learned friend, Lord Hoffmann, in the substantive judgments in this

[1] All subsequent references to Lord Nicholls and Lord Hoffmann are to *Nykredit*, unless otherwise indicated.

> case [1997] A.C. 191, a defendant valuer is not liable for all the consequences which flow from the lender entering into the transaction. He is not even liable for all the foreseeable consequences. He is not liable for consequences which would have arisen even if the advice had been correct. He is not liable for these because they are the consequences of risks the lender would have taken upon himself if the valuation advice had been sound. As such they are not within the scope of the duty owed to the lender by the valuer.
>
> For what, then, is the valuer liable? The valuer is liable for the adverse consequences, flowing from entering into the transaction, which are attributable to the deficiency in the valuation. This principle of liability, easier to formulate than to apply, has next to be translated into practical terms. As to this, the basic comparison remains in point, as the means of identifying whether the lender has suffered any loss in consequence of entering into the transaction. If he has not, then currently he has no cause of action against the valuer. The deficiency in security has, in practice, caused him no damage. However, if the basic comparison throws in up a loss, then it is necessary to inquire further and see what part of the loss is the consequence of the deficiency in the security."

17. Accordingly the basic comparison requires the court to value both the security and the borrower's covenant and to see whether, and if so when, their combined values became worth less than the amount outstanding from time to time under the mortgage. I shall assume for limitation purposes that this was a "no-transaction" case. The parties have agreed for the purpose of limitation (but not quantum) that I should regard the interest actually accruing on the mortgage as representing the cost of funding.

<u>The burden of proof</u>

18. In *Cartledge v. Jopling* [1963] AC 758 at 784, Lord Pearce said:

> "I agree that when a defendant raises the Statute of Limitations the initial onus is on the plaintiff to prove that his cause of action accrued within the statutory period. When, however, the plaintiff has proved an accrual of damage within the six years (for instance, the diagnosis by X-ray in 1953 of hitherto unsuspected pneumoconiosis) the burden passes to the defendants to show that the apparent accrual of a cause of action is misleading and that in reality the cause of action accrued at an earlier date."

19. This passage was quoted by Robert Walker LJ in *DNB Mortgages Ltd v.Bullock & Lees* [2000] PNLR 427 at 434-5 ("*DNB*"), who applied it as follows:

> "In the present case the undisputed facts that [the borrower] obtained a status mortgage and managed to pay the requisite monthly instalments until January 1991 were sufficient to raise a rebuttable presumption that the mortgagor's covenant was good until then; in other words, to indicate an apparent accrual of DNB's cause of action within the limitation period. It was then for the surveyors to adduce evidence to show that that apparent accrual within the six-year period was misleading."

20. Mr de Verneuil Smith, for the Lender, focused on Lord Pearce's use of the indefinite article ("an accrual"). He submitted that he need only establish that relevant, measurable loss first accrued after 23rd October 2007 in order for the burden of proof to shift for all purposes to the Valuer. In contrast Mr Carpenter, for the Valuer, submitted that there could only be a single accrual. The burden was on the claimant to show a provide prima facie case for saying that the cause of action accrued inside the limitation period, whereupon the burden shifted to the defendant.

21. In my judgment the Lender's submission falls into the trap of construing Lord Pearce's words as if they were a statute. The House of Lords was faced with the task of reconciling two principles: (i) that the burden of proof is generally on a claimant and (ii) that limitation is a defence which must be raised and proved by the defendant. I agree with Mr Carpenter that there can only be one date on which the cause of action accrued. I understand Lord Pearce to mean that the burden is on the claimant to establish a prima facie case that the cause of action accrued on a date within the limitation period; if that is established, the burden shifts to the defendant to show that it accrued outside the limitation period.

<u>Whether to take account of facts unknown to the parties</u>

22. The Lender submitted that the security should be valued without regard to the right of way, since this was unknown to both parties at the date of the valuation and at the date of the mortgage advance. It appeared that it came to light only when the Property was repossessed and sold. The purchasers agreed a partial release with the owner of the dominant tenement on the day before completion.

23. The basic comparison requires the court to ascertain the actual value of the security. This must include all factors which actually affected the value of the security at the relevant time, whether or not they were known to the parties. I can see that it might be different if there were some hidden defect which would not reasonably have been discoverable on a hypothetical sale at the relevant date, since such a defect would not have affected the market value of the security. However, that is not this case. The right of way was in fact discovered by the ultimate purchaser and I have no reason to conclude that it was not reasonably discoverable in 2005-6.

24. The basic comparison is designed to establish the total direct loss which would not have been suffered, but for the negligence. In other words, it is equivalent to the measure of damages for fraud. It is well established that damages for fraud include loss which would not have been suffered but for the fraud, notwithstanding that such loss was caused by

some other event outside the knowledge of the parties: *Smith New Court Securities Ltd v. Citibank NA* [1997] AC 254.

25. Mr de Verneuil Smith submitted that this outcome would lead to injustice in some cases, in that a cause of action may accrue before the claimant becomes aware, or should reasonably have become aware, of the relevant facts. To this there are two answers. In the first place, Lord Nicholls (at 1633D-E) regarded it as anomalous that the limitation period could be extended by bringing what was, in substance, the same claim in tort rather than contract. He said that, within the bounds of sense and reasonableness, the policy should be to advance, rather than retard the accrual of a cause of action in tort. Secondly, I accept that there might be injustice if a cause of action expired without the claimant being aware of its existence, but Parliament has remedied the position by adding section 14A to the Limitation Act 1980. In this particular case, any appeal to sympathy rings hollow, given that the Lender's solicitor wrote the initial Protocol letter to the Valuer on 9th December 2009, nearly four years before the issue of the Claim Form.

Whether to take account of hindsight

26. It is necessary to distinguish between two forms of hindsight. The first relates to subsequent unexpected facts or events, e.g. the borrower unexpectedly winning the lottery or losing his job. The second relates to subsequent events which confirm or throw light on trends or risks that were apparent at the relevant date. The distinction is clear in theory, even though in some cases it might be difficult to say on which side of line a subsequent fact or event falls. In the present case there is no such difficulty. The most important subsequent events relate to the financial affairs of the Borrowers and their company SCP.

27. In my judgment this second form of hindsight should be taken into account. Not only is this the fair and sensible solution, but it also accords with authority. As Lord Hoffmann graphically put it in *South Australia Asset Management Co Ltd v. York Montague Ltd* ("*SAAMCO*") [1997] AC 197 at 220:

> "The court was not obliged to take the borrower to be the prosperous tycoon which everyone thought him to be at the date of the valuation but could have regard to the fact that he had afterwards been shown to be a fraudulent bankrupt".

This dictum was relied on by Robert Walker LJ in *DNB* (at 436C). In that case the Court of Appeal upheld the judge's decision on the ground that the subsequent bankruptcy of the borrower showed that his covenant did not have sufficient value to cover the shortfall at an earlier date. (Mr Carpenter relies on this as an example of a covenant being held to have insufficient value at a point in time before the borrower defaulted.) Hindsight of the second kind which I have identified was also taken into account by Mr David Oliver QC in *The Mortgage Corporation v. Lambert & Co* [1999] Lloyds PN 947 at 950.

The value of the security

28. It is agreed that the value of the Property at the date of the mortgage advance was £430,000, if one ignores the right of way to which it was subject, and £397,500 (a reduction of 7½%), if the right of way is taken into account. I am satisfied that I should take account of the right of way, both because it was a fact which objectively affected the value of the security at the relevant date and because its subsequent discovery is an example of hindsight which confirms, rather than alters, the previous position.

29. I turn next to the costs of repossession and sale. Two issues arise:

29.1 Should I take such costs into account? and

29.2 If so, should I take account of the actual costs or of notional costs, and if so, in what sum?

30. Lord Nicholls said that the basic comparison typically calls for an evaluation of the rights acquired, "namely the borrower's covenant and the true value of the overvalued property" (1631F). Lord Hoffmann referred to "the security … being worth less than the sum which the valuer had advised" (1638C). Lord Hoffmann also said that "loss will easily be demonstrable if the borrower has defaulted, so that the lender's recovery has become dependent upon the realisation of his security and that security is inadequate" (1639B).

31. Mr de Verneuil Smith submitted *in terrorem* that no judge has ever previously taken such costs into account. That may be so, but neither side was able to take me to any previous case in which the point had been taken or had mattered. The extracts which I have quoted from *Nykredit* could be read either way, but on balance I am satisfied that Lord Hoffmann was focusing on the value of the security (as distinct from the value of the property), and that this in turn depended on the repossession and sale of the property. In my judgment that is undoubtedly the just result and gives proper effect to Lord Nicholls's basic comparison.

32. If the actual costs were unexpectedly large because of some unforeseeable supervening event, then I would agree that they could not be taken into account. However, if they merely confirm the anticipated costs, then they may be taken into account (see paragraphs 26 and 27 above).

33. The Lender submitted that the costs were exceptional because of management costs incurred during the year between repossession and sale. As against that, it appears that the costs of repossession were low because the Borrowers voluntarily gave up possession. I also note that the Lender was in a much better position than the Valuer to adduce evidence of the usual costs. Mr de Verneuil Smith sought to adduce this evidence from his sole witness of fact, Mark Schofield, but Mr Carpenter objected. I upheld the objection on the ground that the evidence should have been summarised in a witness statement or a supplemental statement, and that the Valuer would suffer real prejudice because there had been no time to pursue inquiries which might lead to fruitful cross-examination. In the circumstances, I am satisfied that I should treat the actual costs as the only evidence of the likely costs on a notional realisation of the security at an earlier date.

34. Accordingly I conclude that the value of the security in March 2006 was £385,818 (after deducting 7½% for the right of way and a further 3% for the costs of sale). The parties

have agreed that the value rose by 12½% £434,269 in a straight line between 16th March 2006 (the date of completion) and 22nd October 2007 (the day before the start of the limitation period).

The value of the Borrowers' covenant

35. Although Lord Nicholls said that "ascribing a value to the borrower's covenant should not be unduly troublesome" (1632C), in practice it has proved to be very difficult, as is shown by the present case. The easiest starting point is to compare the value of the security with the amount outstanding from time to time and to ask, wherever there is a shortfall, whether the value of the borrowers' personal covenant was sufficient to cover such shortfall from time to time.

36. I therefore compare the value of the security with the amount outstanding under the mortgage, in order to see what value would need to be attributed to the Borrowers' covenant ("the Covenant") so as to bridge any gap from time to time. On the basis of the facts which are agreed or which I have found, the figures are as follows:

Date	Value of security	Sum outstanding	Gap to be bridged
16.3.06	£385,818	£428,791	£42,973
2.2.07	£412,846	£431,006	£18,520
2.6.07	£422,425	£435,643	£13,218
22.10.07	£434,269	£432,814	N/A

37. A curious feature of this case is that there is one factor (the increasing value of the Property) which tends to reduce the gap, and a countervailing factor (the increase in the amount outstanding) which tends to increase the gap. In these circumstances the valuation of the Covenant from time to time becomes critical. The Lender rightly accepted that, if the cause of action accrued at any time before the start of the limitation period, the claim was not saved by the fact that the gap was subsequently extinguished.

38. The Lender relied on dicta of Lord Nicholls and Lord Hoffmann who both appeared to have assumed that the Covenant should be valued on the basis of a hypothetical sale by the lender of its entire portfolio. However in *DNB* at 436F, Robert Walker LJ declined to follow these dicta and held that the Covenant should be valued on its own and not as part of an entire loan book. The Lender submitted that the valuation should be carried out on the hypothesis of a sale by the lender of this debt in isolation. There is nothing in *DNB* to warrant that approach. I was shown no evidence that there is any ready market in the sale of individual mortgage covenants and I would be surprised if there were such a market. In my judgment the exercise which is required is the valuation of the Covenant in the light of all admissible evidence.

39. It is because this is such a difficult exercise that it becomes important to go back to the burden of proof. Mr de Verneuil Smith submitted that Lord Nicholls intended the test to be a simple one and that a sensible test would be whether there were "substantial arrears". This test merely substitutes an unclear formula for that laid down by Lord Nicholls. It would cause unnecessary difficulty in determining what is meant by "substantial".

40. He also referred to *Kenny & Good Pty v. MGICA Ltd* [2000] Lloyds PN 25 at 29. In that case the High Court of Australia said that the cause of action accrued when recoupment was rendered impossible, which was no earlier than when default occurred and no later than when the property was sold. I derive no assistance from this *obiter dictum*, given that there is sufficient English authority which is binding on me and given that this case is principally authority for the proposition that *SAAMCO* is not to be followed in Australia.

41. He also relied on the evidence of Mr Schofield, who said that the Lender would normally consider a mortgagor to be in default after four months of arrears. I was unimpressed by that evidence. In the first place, the test does not depend on this particular lender's practices but on an objective valuation of the Covenant. Secondly, if the evidence was tendered as evidence of a general practice in the industry, then it is inadmissible because Mr Schofield was not called as an expert. Thirdly, it overlooks the fact that most lenders view repossession as a last resort and that the covenant of a borrower whose payments are erratic might be regarded as impaired long before the loan is formally treated as being in default. I also bear in mind that the choice is not just between a good covenant and a worthless one; in this case, the Covenant plainly had some value at least during part of 2007 and I need to decide what that value was.

42. Conversely Mr Carpenter submitted that I should infer from a single delay in payment that the Covenant was worthless. I reject this test as being too crude. A single hiccup may be readily explainable in some cases, though not others.

43. Having said that, I do agree that the test needs to be a simple one, at least at the initial stage of asking whether the Lender has established a prima facie case that loss first accrued within the limitation period. I draw assistance from the following statement of Lord Hoffmann at 1639B-D:

> "There may be cases in which it is possible to demonstrate that such loss is suffered immediately upon the loan being made. The lender may be able to show that the rights which he has acquired as lender are worth less in the open market than they would have been if the security had not been overvalued. But I think that this would be difficult to prove in a case in which the lender's personal covenant still appears good and interest payments are being duly made. On the other hand, loss will easily be demonstrable if the borrower has defaulted, so that the lender's recovery has become dependent upon the realisation of his security and that security is inadequate. On the other hand, I do not accept [the] submission that no loss can be shown until the security has actually been realised. Relevant loss is suffered when the lender is financially worse off by reason of a breach of the duty of care than he would otherwise have been."

The test which I adopt in this case is whether (i) the Covenant appears good <u>and</u> (ii) interest payments are being duly made. I accept that, in order to discharge the initial burden of proof, the Lender need only show prima facie evidence to this effect.

44. Mr de Verneuil Smith submitted that the cause of action accrued in May 2009 (the date of sale of the Property) or January 2008 (the date of the Borrowers' last payment). I have no hesitation in rejecting May 2009, because it is inconsistent with Lord Nicholls's

definition of the basic comparison. The position regarding January 2008 depends on whether the Lender has produced prima facie evidence that the Covenant appeared good and that interest payments were being duly made immediately before that date.

45. Mr Carpenter submitted that the cause of action accrued on Day One because the Covenant was never sufficient to bridge the initial gap of £42,973. In my judgment, however, the Lender has satisfied me that prima facie the Covenant was worth at least this amount on 16th March 2006. A direct debit had been set up and payments were made regularly and punctually for the next 10 months. (I will consider below whether the Valuer is able to rebut that prima facie case.)

46. However, the position changed when the first instalment was missed in February 2007. Whilst that does not automatically make the Covenant worthless, it does make it necessary to look at the subsequent history of payments and promises during 2007 (I have taken the communications between the Lender and the Borrowers from the Lender's Internal Memos Report):

46.1 On 2nd February 2007 a direct debit payment was returned unpaid, giving rise to a returned direct debit fee of £30, and the Borrowers paid by debit card on 5th February[2].

46.2 On 7th March the Borrowers said that they would have funds available next week and they sent a direct debit mandate. On 14th March they reported that they were refinancing bank accounts which was taking a while to complete but would make a payment by debit card before the end of the month. On 26th March they paid £2,013 by debit card.

46.3 On 4th April they reported that they were awaiting new bank details and would make the payment that month by debit card, after which they would pay by direct debit. There were further conversations to the same effect on 10th and 13th April. On 20th April the Borrowers told the Bank that they were waiting for funds to be released from the bank for a piece of land which they were buying. I assume this means that they were proposing to use the mortgage moneys on the new land to service the instalments on the mortgage with which I am concerned. They said that they would make a token payment, and on 25th April they paid £50 by debit card. On 25th April the Lender noted that it was reviewing the account because it needed payment.

46.4 On 1st, 9th and 16th May the Borrowers reported that they were selling land (they had previously said that they were buying land; it is not clear if this refers to the same land) but this was taking longer than expected. The Lender's review on 21st May concluded that the position was unacceptable and that the full arrears needed to be cleared. On the same day (21st May) the Borrowers said that they would make a debit card payment by the end of the week to bring the account up to date. However, no payment was made that month and the Lender charged an administration fee of £50.

[2] The amounts due each month according to the mortgage account do not tally precisely with the amounts paid by the Borrowers. I have assumed, in the Lender's favour, that where the amounts are broadly similar, the Borrowers paid the amount requested by the Lender and that the discrepancy was due to some other factor such as a change in LIBOR. This was the case in February and March 2007 and in January 2008.

46.5 On 13th June the Borrowers paid £6,313 by direct debit. This was equal to approximately three months interest and therefore more or less cleared the arrears.

46.6 On 4th July they said that they would pay the next instalment by debit card the following week, but then gave further excuses on 12th and 18th July. The Lender conducted further reviews on 19th and 27th July, concluding unsurprisingly that payment was required. On 31st July they paid a mere £100.

46.7 A further review on 10th August concluded: "Waiting for funds, from what? This is more than one month outstanding. Want mortgage up to date ASAP!". Thereafter they made the following payments by debit card: £3,000 on 31st August, £3,000 on 28th September and £3,200 on 25th October. These payments exceeded the interest charges for those months, but not by a large enough margin to cover the unpaid instalment in July.

46.8 The next payment was a debit card payment of £2,537 on 2nd January 2008. Thereafter no further payment was made, save for a fee of £25.

47. The gap which needed to be bridged on 2nd February 2007 was £18,550 (see paragraph 36 above). In my judgment the Lender has failed to produce prima facie evidence that the Covenant was worth at least this amount on that date. My reasons are as follows:

47.1 The failure of the direct debit payment in February was significant. Although payment was made in February, it was no longer the case that interest payments were "duly" made. Nor am I prepared to infer from the mere fact of payments being made that the Covenant "still appeared good". On the contrary, I cannot shut my eyes to the Borrower's broken promises and assurances throughout 2007, the failure to reinstate the direct debit, the delays and missed payments, the cessation of payments in January 2008 and the eventual bankruptcy of the Borrowers. There is nothing to indicate that these were unexpected events. On the contrary, they indicate a typical picture of a small-scale builder who is financially overstretched, is dependent upon property prices continuing to rise, and is in no position to withstand a recession. The eventual bankruptcies merely confirm a pattern which was readily apparent at least by early 2007.

47.2 In January 2007 the Lender was asked to approve, and did approve, a second mortgage over the Property. Whilst this does not by itself establish that the Covenant no longer appeared good, it is undoubtedly relevant read in conjunction with the financial difficulties clearly encountered from February 2007.

47.3 The loan was a non-status loan for which the Borrowers certified their own income. This was an indication that the Lender attached considerably less weight to the value of the Covenant than would have been the case if the Borrowers' creditworthiness had been fully investigated. It is also an indication that the Borrowers did not regard themselves as having a good credit rating, since it is likely that they could have obtained a mortgage on more favourable terms if the Covenant had been proved to be a first-class one. Although I am concerned with the actual value of the Covenant, rather than any inference I can draw as to the value ascribed to it by the Borrower and the Lender, this is nevertheless a relevant piece of evidence, at least in reaching a prima facie view as to whether the Covenant appeared good.

48. I therefore conclude that the Lender has failed to discharge the prima facie burden of showing that the loss had not accrued by 2nd February 2007. In case I am wrong about that, I am satisfied that the Lender also failed in subsequent months. A prime example is 2nd June 2007, by which time the Borrower had paid nothing since March 2007. Mr Schofield gave evidence that in practice the Lender permitted payment at any time during the month, even though there was no provision to this effect in the mortgage conditions or the Lender's manual. That cannot affect the fact that the Borrower paid nothing in April or May, that the Lender had cause for concern as to whether payment would be made in June, and that it had been sufficiently concerned to undertake a review in May.

49. I have reached this conclusion without looking at the expert evidence, but I now turn to that evidence in case I am wrong. If, contrary to my conclusion, the Lender has established that prima facie the claim form was issued in time, it is then up to the Valuer to rebut that conclusion.

50. The Lender called Mr Greg Lacey, a chartered accountant, to give expert evidence. The Valuer called no expert evidence. Mr de Verneuil Smith submitted that Mr Lacey's evidence was inadmissible because he was not an expert in the relevant discipline, which was that of mortgage lending. However, no evidence was called to show that there is a recognised method of valuing the personal covenant of a mortgagor or a recognised market in trading in such covenants. Counsel relied on *Barings plc v. Coopers & Lybrand* [2001] PNLR 22 at [45], where Evans-Lombe J held that expert evidence was admissible:

> "in any case where the court accepts that there exists a recognised expertise governed by recognised standards and rules of conduct capable of influencing the court's decision on any of the issues which it has to decide and the witness to be called satisfies the court that he has a sufficient familiarity with and knowledge of the expertise in question to render his opinion potentially of value in resolving any of those issues".

51. Mr Lacey as a chartered accountant is governed by rules of conduct which are designed to promote honesty and competence and he applies recognised principles and assumptions in seeking to build a picture of the Borrowers' financial worth and future prospects. Their worth and future prospects do not themselves equate to a valuation of the Covenant, but they are clearly relevant and essential ingredients in reaching a valuation. I am therefore assisted by hearing evidence from a competent accountant who is used to evaluating the worth and future prospects of individuals, even if he has never previously had to value a mortgage covenant as such.

52. I can take the matter shortly, given my conclusion that the claim became statute-barred at least by February 2007. Mr Lacey has sought to ascertain the position as best he could, with very limited information. It was not the Valuer's fault that Mr Lacey had so little information. The Lender was presumably in a position to provide more information but has not done so. In summary, Mr Lacey's evidence was as follows:

    52.1 The Borrowers' only source of income was their company SCP. Although Mr Slee might have drawn an income of £165,000 the previous year, SCP was insolvent by 2004 and the position had worsened by 2006, so that the deficit was nearly £49,000.

Accordingly Mr Lacey concluded that the Borrowers could not properly draw any money from SCP at any time during the life of this mortgage.

52.2 Mr Lacey looked at the Borrowers' known assets and liabilities and concluded that by March 2006 they had £28,130 in cash and no other known assets of value. The only known assets were a property at 17 Highbank, Brighton, which was mortgaged to Amber, and a boat which was also mortgaged. Since Mr Lacey did not know whether these assets had a positive or negative equity, he treated the assets and the mortgages on them as cancelling one another out.

52.3 He deducted the mortgage liability and the Borrowers' estimated weekly expenditure and other known liabilities from this cash sum and made a calculation of the net projected outflow of cash from March 2006 to October 2007. This gave a net present value of £20,096 for cash outflow, leaving a surplus of £8,034.

53. Mr de Verneuil Smith challenged this evidence on three bases:

53.1 He said that Mr Lacey was not an expert in valuing covenants. I have already dealt with this point. I note that Mr de Verneuil Smith did not challenge the methodology used by Mr Lacey.

53.2 He criticised Mr Lacey for using hindsight. I have already dealt with this. I am satisfied that Mr Lacey did not use impermissible hindsight (see paragraphs 26 and 27 above).

53.3He challenged some of Mr Lacey's assumptions, in particular his assumptions about the boat and 17 Highbank.

54. Mr Lacey accepted in cross-examination that it was arguable on the evidence that the equity in the boat might have been worth £2,260.

55. As regards 17 Highbank, SCP bought this property in September 2005 for £75,000 and immediately sub-sold it to Mr Slee for £150,000. Mr Slee mortgaged that property to Amber for an unknown sum, the monthly mortgage instalments being £894. According to Mr Lacey's unchallenged evidence, the Amber mortgage provided for "up to 95% borrowing on land – up to 95% borrowing on the build – up to 90% final LTV" [loan to value ratio]. The property was not marketed for sale until January 2009, and therefore I must assume that the LTV in 2006-8 was 95%, not 90%. Hence, at best the equity in September 2005 might have been £7,500. If one indexes the figure of £150,000 in accordance with the Land Registry index of transactions in East Sussex, the value of the equity rises to £9,212 in March 2006, £19,244 in February 2007 and £24,102 in June 2007.

56. However, there are three factors which make this valuation of the equity in Highbank somewhat unreal:

56.1 Although I am prepared to assume Amber obtained a valuation in the sum of £150,000, the subsale does look suspiciously like a mortgage fraud.

56.2 I find it surprising that Amber was apparently willing to lend a greater proportion of the value of the half-completed development than of the finished product. In practice, I would expect a half-finished development to be worth less than the sum of the land and the costs of development, particularly if it is a self-build development and the owner might well run out of money to complete it.

56.3 The value of the Covenant depended not just on balance-sheet assets, but also on liquidity. A half-completed development cannot readily be turned into cash. This is borne out by what actually happened: Highbank was not put on the market until January 2009 and was not sold until December 2011.

57. There is some force in the points made by Mr de Verneuil Smith about the boat and Highbank, as Mr Lacey readily recognised. The position is not clear-cut, and I do not regard the points as undermining my overall confidence in Mr Lacey as an expert.

58. I must now consider whether, insofar as the burden of proof was on the Lender, it has discharged that burden on various dates:

58.1 In March 2006 the gap which needed to be bridged by the Covenant was £42,973 (see paragraph 36 above). Although I am satisfied that the Lender has established that prima facie the Covenant was worth at least this amount on that date, the position changes upon hearing Mr Lacey's evidence. His evidence is that the true value of the Covenant was only £8,034. Even if I ignore the concerns raised in paragraph 56 above and give full effect to the Lender's arguments regarding other assets, this increases the Borrowers' assets by £2,260 for the boat and by £9,212 for 17 Highbank. This leaves a considerable shortfall. I therefore conclude that the Valuer has discharged the burden of showing that loss accrued in March 2006.

58.2 In case I am wrong, I shall consider later dates. In February 2007 the gap to be bridged was £18,550. Mr Lacey's evidence is that the Covenant had a negative value of £12,999. If I give full effect to the Lender's arguments about other assets, this improves the position by £19,244 + £2,260. That is not enough to plug the gap.

58.3 In June 2007 the gap to be bridged was £13,218. Mr Lacey's evidence is that the Covenant had a having a negative value of £19,673. If I give full effect to the Lender's arguments about other assets, this improves the position by £24,102 + £2,260. That is not enough to plug the gap.

59. I therefore conclude that the claim is statute-barred.

Reliance

60. The burden of proof is, of course, on the Lender to establish that it relied on the Valuer's valuation. The only witness called by the Lender was Mr Schofield, who was the Lender's head of credit at all material times and who remains a senior employee of the Lender. No evidence was given by anyone involved in the actual decision-making, nor was any explanation given for the absence of such evidence. Mr de Verneuil Smith submitted that no adverse inference should be drawn from this absence. He said that that it would be surprising for the Lender to have commissioned the valuation unless it intended to rely on it. I accept that this is a reasonable starting point and that in a

straightforward case it might not take much evidence to discharge the burden of proving that the lender did so rely.

61. I also accept that there is no rigid rule requiring the individuals who sanctioned or approved the loan to give evidence. It might be thought unnecessary in a case where:

61.1 There is a lending manual which contains clear policies or guidance;

61.2 There are internal contemporaneous notes made by the relevant employees;

61.3 A person employed at the relevant time confirms (i) that the Lender's usual practice was to follow its own policies and guidance and (ii) that the notes indicate that they were followed on this occasion; and

61.4 There are no indications to the contrary.

62. However, the present case is not a straightforward one because there were two valuations. This immediately raises the question whether the Lender relied on the Valuer alone, or on Connells alone, or on both. Reliance on both would be sufficient, but the Lender must satisfy the court that it did not rely solely on Connells.

63. There is no explanation in the documents I have seen as to why there were two valuations or as to which valuation or valuations were relied upon. The only documents which might possibly assist are the following:

63.1 Internal computerised notes made by the Lender (known as MIPS Case Notes) contain an entry on 19th December 2005 from one Jennifer Dixon saying: "broker note: 2x vals carried out."

63.2 The MIPS Case Notes also include two further relevant entries. One dated 16th January 2006 from one Laura Paton says: "tried to call robert jaques [the broker] back to let him know that we will instruct a second val due to property [;] line was engaged could not get through". The other dated 19th January 2006 from Jennifer Dixon says: "Broker note: 2nd val instructed through Quest".

63.3 The fax sent to Connells on 13th February 2006 (see paragraph 7 above).

63.4 The Lender's internal underwriting checklist contains a line asking whether the property is "fit for immediate occupation". Next to this is an illegible squiggle which Mr de Verneuil Smith asks me to infer is a "yes" and which is dated 24/2.

63.5 The Lender's underwriting manual as at 1st November 2005 includes the following:

(a) Paragraph 5.2.1 has the heading: "Additional Valuation for High Value Property". In the column headed "Policy" it states: "Any property valued at £500,000 or more will require a second full valuation including internal inspection to be completed." In the column headed "Normal Policy Procedures" it states: "If the second valuation is outside a 10% tolerance from the first valuation, the lower of the two valuation figures will be used when calculating LTV".

(b) Paragraph 5.4 has the heading Unacceptable Security. This includes "Properties determined by the valuer as 'unacceptable security" and "properties built up to 10 years previously without a NHBC Certificate or suitable Architect's Certificate'".

63.6 It appears from the Lender's internal documents that the mortgage application was processed by Jennifer Dixon and Laura Paton and that it was reviewed on 24th February 2006 by two more senior underwriting officers, Kelly Lister and Kathryn Dargan. The MIPS Case Notes also have an entry by one Kelley Boyle on 16th February: I was not told whether she is the same person as Kelly Lister.

64. I accept that Mr Schofield gave credible evidence about the Lender's usual practices. However, I found his evidence considerably less satisfactory when applied to the particular facts of this case. He readily admitted that he had no involvement in sanctioning or approving this loan and had not spoken to anyone who had been involved. He was able to throw some light on the abbreviations used in the internal notes, but he could not interpret all of them. He was unable to satisfy me as to precisely who approved the loan and when, and in particular, whether that approval was made in reliance on the Valuer's valuation.

65. He did not know why the Lender sought a second valuation from the Valuer, instead of going back to Connells. He suggested that the reason was that the Connells' valuation was unsatisfactory, given that this was a self-build development which had not yet been completed, so that the Property was not suitable as mortgage security at the date of the Connells' valuation. His reasons for reaching that conclusion were unsatisfactory, and they confirmed my concern that this part of his evidence was little more than speculation. In particular:

65.1 He relied on paragraph 5.2.1 of the lending manual which gives guidance to the effect that the Lender should adopt the lower of two valuations where there was a difference of more than 10%. He said that this demonstrated that the Lender relied at least in part on the Valuer's valuation, even though the letter of offer gave a value of £475,000. I reject this as pure speculation. The lending manual gives no assistance, since (i) it applies only where the lower valuation is lower by 10% or more (in this case it was only 5%) and (ii) it is merely guidance and not policy.

65.2 He relied on paragraph 5.4 of the lending manual which referred to (i) unacceptable security and (ii) properties which did not yet have their NHBC certificate. In his evidence in chief he said that these were both good reasons for needing a fresh valuation. However, the latter cannot have been the reason, since the NHBC certificate was not obtained until 3rd February 2006 (after the date of the Valuer's valuation) and yet (according to Mr Schofield) that did not prevent the Lender from relying on that valuation. In cross-examination he sought to distance himself from reliance on the lack of a NHBC certificate.

65.3 As for the former reason, this is pure speculation. I note that Connells had said that the Property was suitable for mortgage purposes and that its valuation was subject to satisfactory completion of the development. If one takes the Connells' valuation at face value, it was satisfactory. It was merely subject to a condition which the Lender might reasonably have regarded as satisfied when it saw the NHBC certificate.

65.4 He relied on Laura Paton's note of 16th January 2006 saying that the second valuation was being sought "due to property". He said that this indicated that the reason was because of the nature of the Property, rather than the valuation, but that is pure speculation. As Mr Carpenter points out, it is undermined by the earlier note of 19th December (which preceded the Connells' valuation) saying that two valuations would be carried out.

65.5 He referred to the fax of 13th February but this does not say what "policy" is being referred to.

65.6 He relied on the confirmation dated 24th February 2006 that the Property was fit for immediate occupation, saying that this was a conclusion that could only have been reached in reliance on the Valuer's valuation. I do not accept this evidence: it is equally possible that this conclusion was reached in reliance on the Connells' valuation together with the NHBC certificate. I regard it as significant that the loan offer stated the value as being £475,000 (the amount of the Connells' valuation) rather than £500,000. This is a prima facie indication that the Lender relied on the Connells' valuation, and possibly on that valuation alone. It is certainly possible that the Lender relied on both valuations, but I cannot properly draw that inference on the evidence before me.

66. I also regard it as significant that Mr Schofield's evidence, to the effect that the loan was made in reliance on the Valuer and not simply on Connells, was given for the first time in the witness box and is not to be found in his witness statement dated 15th March 2015. This reinforces the view (which I would have reached independently) that the Lender at the eleventh hour has sought to cobble together a case on reliance which is based largely on speculation with no real foundation. The claim therefore fails because the Lender has failed to establish reliance.

Quantum

67. In view of my findings on limitation and reliance, this does not arise. I will take it briefly in case the matter goes any further. There were three principal issues.

68. The first related to the cost of funding. The Lender adduced no evidence of the cost of funding. It is well established that the Lender is not entitled to claim the amount due by way of mortgage interest: *Swingcastle Ltd v. Alastair Gibson* [1991] 2 AC 223. Although the Valuer accepted the mortgage interest as representing cost of funding for limitation purposes, this was not conceded in relation to quantum. The Lender submitted that I should award 1% above LIBOR, but I would have been unable to do so in the absence of evidence. However, if I had found in the Lender's favour, I would have awarded a cost of funding at a rate equal to LIBOR on the basis that (i) the Lender was a commercial entity and (ii) the mortgage was itself tied to LIBOR.

69. The second issue arises from the fact that the mortgage offer valued the Property at £475,000, even though the Valuer's valuation said £500,000. Mr Carpenter submitted

that the *SAAMCO* cap should not be the full £70,000 (i.e. £500,000 – £430,000[3]) but should be limited to £45,000. The term "*SAAMCO* cap" is a misnomer, albeit a convenient label. Lord Hoffmann explained in *SAAMCO* at 218A-C that it arises because of the interaction of two separate rules: (i) that the claimant's damages are limited to his actual loss (i.e. loss which would not have been suffered, but for the negligence) and (ii) that the defendant is liable only for such loss as falls within the scope of his responsibility. If this is seen as a Venn diagram, then the damages are limited to the intersection between the two circles. However, as Lord Hoffmann noted in *Nykredit* at 1624F, it is also necessary to take account of the rules of causation. If the Lender did not in fact rely on the Valuation for more than £475,000, then damages must be limited accordingly. Since this cannot be done by limiting the actual loss (see paragraph 24 above), I agree with Mr Carpenter that it become necessary to reduce the *SAAMCO* cap. This also accords with Lord Nicholls's definition of the *SAAMCO* cap (see the third paragraph which I have set out in paragraph 16 above).

70. Mr de Verneuil Smith argued that, although the Lender acted prudently in adopting the lower valuation from Connells, it nevertheless relied on the higher Valuation as giving additional comfort. I agree that, if this were so, the *SAAMCO* cap would be the full £70,000. However the Lender has not established such reliance on the evidence before me.

71. The third issue is whether this should be seen as a no-transaction or a lesser-transaction case. Mr Schofield accepted that the Lender would be have willing to lend 90% of £430,000. Mr Carpenter submitted that this is what would have happened, if the valuation had been competent. The Lender submitted that the Borrowers were seeking to raise as much money as they could and would not have been satisfied with a smaller loan. However, that would have depended upon the likelihood of the Borrowers finding (i) an imprudent lender who was willing to lend more than 90% of the true value or (ii) a lender who consulted a different negligent valuer. Given that the burden of proof is on the Lender as claimant, I am not prepared to conclude that there would have been no loan.

<u>Disposition</u>

72. Accordingly I dismiss the claim on two grounds, firstly because it is statute-barred and secondly because the Lender has failed to prove reliance. I will hear the parties as to the form of the order in this case.

73. Finally I wish to thank both counsel for their excellent submissions, both orally and in writing.

[3] For this purpose I ignore the right of way, since there is no allegation of negligence in failing to discover its existence.