“Last man standing”

July 2017

What duties does a monitoring surveyor owe to a lending bank?

***(1) The Governors and Company of the Bank of Ireland (2) Bank of Ireland (UK) Plc v Watts Group Plc* [2017] EWHC 1667 (TCC)**

Background

The Bank of Ireland (the Bank) claimed for damages against the defendant project monitor, Watts.

The claim concerned a development of 11 apartments in York. The Bank made a loan facility of £1.4m available to a borrower and proposed developer, Derwent Vale York Limited (the Developer), an SPV owned jointly by Derwent Vale Developments (DVD) and Modus Partnerships Limited (MPL). MPL was a newly incorporated subsidiary of a property development group known as Modus, which the Bank considered to be a key client. On 8 June 2007 the facility was approved, subject to certain conditions, which included the appointment of a monitoring surveyor to verify the build costs and make sure the development was viable.

The Bank allowed the first tranche of the loan facility, of £210,000 (the Land Loan), to be drawn down for the Developer to purchase the land for the development, on 14 September 2007. The balance was intended for development costs. At the same time, MPL provided a capital guarantee of £200,000 to the Bank, and MPL and DVD entered into a cost overrun and interest shortfall guarantee. DVD, which was also the project’s contractor, entered into a fixed price contract for the construction works.

On 10 January 2008 the Bank instructed Watts as its monitoring surveyor, and Watts subsequently prepared an Initial Appraisal Report (the Report). The Report was provided to the Bank on 8 April 2008, and in accordance with Watts’ retainer it confirmed, amongst other things, that:

- the Developer’s construction costs of £999,099 was a realistic estimate for the project
- the Developer’s build programme of 52 weeks was reasonable
- the Developer’s cashflow was adequate, and
- further scheme design drawings and building contract documents were awaited.

Allegedly in reliance on the Report, the Bank proceeded to allow drawdowns under the facility for development costs, and construction works commenced.

Any comments or queries?

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In May 2009, MPL's ultimate parent company went into administration, which in turn caused the Developer to become insolvent, and construction ceased. The Developer was subsequently placed into liquidation, and the Bank demanded repayment of the loan facility. No repayment was made, and the Bank ultimately sold the incomplete development on 1 April 2011, for £527,473.

The claim

The Bank claimed losses of c. £750,000 from Watts on the basis that it had failed to exercise the reasonable skill and care expected of a reasonably competent and experienced monitoring surveyor in preparing its Report.

In particular, the Bank claimed that Watts had grossly underestimated the proposed construction costs, and should have advised that the 52 week construction period was too short. The Bank also alleged that Watts failed to identify a discrepancy in drawings which showed that the proposed scheme differed from that which had received planning permission.

The Bank argued that had any one of these issues been pointed out in the Report, it would have demanded repayment of the Land Loan, and would not have proceeded to provide the facility to the Developer.

Unlike the *Lloyds v McBains Cooper*[1] case, the Bank's pleaded claim only concerned the Report. There was no claim in respect of the monthly progress reports prepared by Watts. Rather, the claim was "all or nothing"; had Watts advised the Bank "non-negligently" at the outset, then the Bank would not have proceeded to permit any further drawdowns from the loan facility, and would have enforced its security over the land in April 2008.

Judgment on liability – what does a monitoring surveyor need to do?

Construction costs

The Bank's main criticism of Watts was that it endorsed the Developer's estimated costs of £999,099. The Claimant's expert criticised both Watts' verification of that figure and the approach to assessing it.

The Judge accepted that Watts, as the project monitor, was not required to take the whole budget apart and do it again themselves, but rather it had to carry out a review of the costs estimated by the Developer, which was also the contractor.

This was in stark contrast to the Claimant's case, which was that Watts should have done their own calculation from scratch, and prepared RICS stage 1 and detailed stage 2 calculations. This was not, however, what the RICS Guidance Note in force at the time said. Also, the Developer had entered into a fixed-price contract for the construction works in any event, taking on the cost risk, and it was reasonable for Watts to take the Developer's budgeted figure (which it had no incentive to underestimate) as a starting point.

The Judge also found that the Bank's allegation that the true construction costs were potentially up to c£1.7m was meaningless; there was no way that Watts should have undertaken the detailed calculations necessary to arrive at such a figure. Overall, the Judge found that Watts' approach to assessing the costs was reasonable. That had included a three stage test including (1) an independent cost check on the rate per square foot, (2) a comparison of that rate per square foot and the Developer's budget as against costs data held by Watts, and (3) a price per apartment comparison between the Developer's budget and similar projects Watts held data for.

Perhaps most importantly, the Judge made it clear that the modest fee paid to Watts, of £1,500 for the Report, meant that it was not expected to do its own detailed calculations of cost, time or cashflow, and he regarded the size of the fee as good evidence of the limited nature of the service which Watts was expected to provide.

1. Lloyds Bank Plc v McBains Cooper Consulting Ltd [2015] EWHC 2372 (TCC)

The Judge was also critical of the lack of realism in the Bank's liability expert evidence; the Bank's expert incurred fees 30 times higher than Watts' fee of £1,500 in preparing his expert report, clearly indicating that his criticisms were based on an entirely unrealistic expectation of what Watts was required to do.

The Judge accordingly found that Watts was not negligent in considering that the Developer's costs were reasonable.

Cashflow

The Bank criticised the Developer's cashflow information, which Watts had also assessed as reasonable in the Report. The Judge did not accept these criticisms, and again found that a project monitor was not required to carry out a detailed forensic analysis, and that its role was to assess whether a borrower's cash flow analysis was a reasonable reflection of the amounts required to complete the works, which is what Watts did.

Programme

Watts approved the Developer's 52 week programme, whereas the Bank alleged this was too short, and that Watts should have advised that a 15 month programme was required. The Bank's expert was, however, unable to identify any particular part of the programme which was over-optimistic, such that Watts was negligent in failing to spot it. It would only be if some element was demonstrably missing, or if some programme duration was clearly underestimated, that the monitoring surveyor would drill down into the detail. The Judge therefore found that there was nothing in the programme which should have caused Watts to conclude that it was unreasonable.

Planning

It was accepted that, had Watts seen the drawings which showed the discrepancy between the proposed development and the obtained planning permission, it would have been negligent for Watts not to have informed the Bank. This was a point accepted by Watts' expert.

The Bank, however, had failed to control the information provided to Watts, and was unable to show that the relevant drawings had been provided. Watts had never received a clear set of drawings which were said to have been approved by way of planning consent, and even the drawings that the Bank alleged Watts had at the time were clearly marked as drafts. Watts was also told that further drawings were being prepared and would be provided, which is what it informed the Bank in its Report. It did not help the Bank's case in this regard that the drawings relied on by its expert to support this allegation were demonstrably not drawings which could have possibly been in the possession of Watts at the time it prepared the Report, as they all significantly post-dated it. The Judge found that the Bank had no-one to blame but itself for not ensuring that Watts was provided with all the relevant information.

Reliance

The Bank did not call a single witness that had actually read or relied upon the Report. Despite this, the Bank was able to establish reliance on the facts, with the Judge stating:

"... in cases like this, the court should assume (unless the evidence points to the contrary) that an employer relies on the professional advice that he has been paid for and has been provided."

Causation, loss and BPE

Despite this, the Judge found that, even if Watts had been found to be negligent on any or all of the four issues above, the Bank had failed to show that Watts caused the loss claimed.

During closings the Bank effectively conceded that it could not make out its pleaded case that even if Watts had advised that the programme and/or cashflow should be different, it would not have proceeded to provide the loan facility.

The Judge also found that, whatever Watts had said about the planning issue (and the Bank already knew about the Developer's intention

to make changes to the scheme for which planning consent had been achieved in order to maximise its profit), the Bank would have proceeded with the facility in any event. It was something about which the Bank already knew.

It was accepted that the Bank may not have gone ahead with the facility had Watts advised that the true construction costs were at the level reported by the Bank's expert. However, the Judge found that there was no evidence which could justify Watts arriving at that figure. It could also not simply be assumed that the development would have been stopped; if Watts had advised that the construction costs should be slightly higher, the Judge considered it overwhelmingly likely that the development would have gone ahead anyway. It was also problematic for the Bank that its witness evidence on causation was predicated on the figure of £1.59m (as per the Bank's expert's view), by reference to which it was said the loan would not have been permitted. No other figures were considered, either in that witness evidence or elsewhere, with the Bank's expert also failing to take into account any margin of error. The guarantees obtained by the Bank also showed it was more interested in how the loan would be repaid than the actual construction costs.

The Judge considered the recent Supreme Court case of *BPE v Hughes-Holland*[2], and found that this was a case in the "information" category, which meant that Watts' was to provide the Bank with certain kinds of information. In the Judge's view, it can only have been the information on construction costs which could ever give rise to a claim against Watts, this being the information the Bank was going to rely on in deciding whether to provide the facility. Watts could only be liable for the financial consequences of that information being wrong, and not for the financial consequences of the Bank entering into the transaction. The Bank pleaded no alternative basis for its loss. As such, it had failed to show that any loss arose from its allegation that the information Watts provided on the construction costs was incorrect.

Ultimately, the Judge's view was that the true cause of the Bank's loss was its flawed decision to lend to the Developer. The loan facility breached three out of four of the Bank's own lending guidelines, and relied on blind trust in the Developer's ultimate parent company, Modus, a key customer for the Bank. It also ignored the tight profit margins on this project.

Contributory negligence

The Judge went on to conclude that, in any event, even if he was wrong on the scope of Watts' duty, breach and the true cause of the loss, and if the Bank had been able to recover, any damages would have been reduced by 75% for contributory negligence.

Conclusion

This is a judgment packed with interesting and useful points for monitoring surveyors, professionals, litigants in general and their insurers. The judgment:

- provides welcome guidance on what it is a monitoring surveyor is expected to do, and the limitations of the role
- affirmed the principle in BPE, and applied it to the scope of a monitoring surveyor's retainer for the first time, confirming that the monitoring surveyor does not underwrite a bank's development risks
- highlighted that there is effectively a rebuttable presumption that a professional's advice will have been relied on by the client
- highlighted the critical importance of ensuring that your expert witnesses are fully conversant with the obligations they owe to the court, and do not stray into advocacy
- clarified that a claimant's own failings can be the true cause of its losses, even if a professional has been negligent. While in this instance Watts was found to have acted with reasonable skill and care in all the circumstances, the Judge concluded that even if he was wrong on that the Bank's poor lending was the true cause of its losses.

RPC acted for the successful Defendant, Watts Group Plc, in this claim.

2. BPE Solicitors v Hughes-Holland [2017] UKSC 21

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