Is time up for claims against valuers?

Assessing the point at which a cause of action accrues in a claim against a valuer is a difficult task, not least because of the lack of judicial guidance on the issue. Helpfully, the recent county court case of *Canada Square Operations Limited v Kinleigh Folkard & Hayward Limited*, decided on 17 September 2015, has shed some further light on how to approach this difficult task.

The case concerned an alleged negligent valuation by Kinleigh Folkard & Hayward Limited of a residential property. The defendant admitted negligence but one of the remaining key issues to be decided by the court was whether the claimant's claim was time barred. The loan had been taken out in March 2006 and the borrowers had made regular payments until January 2007, but then payment became erratic, until the final payment was made on 2 January 2008.

In his judgment, recorder David Halpern QC summarised the test set out in *Nykredit Mortgage Bank Plc v Edward Erdman Group Ltd* as "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".

He expressly agreed with the defendant that there can only be one date on which the cause of action accrues, although he did concede the difficulty in establishing that precise date.

The parties had agreed the "true" value of the property. In valuing the security provided by the property, however, Mr Halpern QC decided that the claimant's costs of repossession and sale should be deducted, despite there being no legal authority for this point. He justified his view with reference to Lord Hoffmann's focus in *Nykredit* on the value of the *security*, as opposed to the *property*. He also decided that a deduction should be made of 7.5% to take into account a right of way that was discovered during the sale of the property following repossession by the claimant (even though neither the claimant nor the defendant had known about the right of way), on the basis that the right of way was reasonably discoverable when the loan was made. Taking into account these deductions, Mr Halpern QC concluded that, in March 2006, the value of the security was £385,818. He further agreed with the parties that the value of the security had risen by 12.5% between March 2006 and October 2007, in line with the growth in the property market.

The judge then compared the value of the security with the outstanding amount of the loan at various points in the loan, until repayments had ceased being made, in order to ascertain the value that the borrowers' covenant needed to attain, from time to time, in order to bridge the shortfall.

In assessing the value of the borrower's covenant, Mr Halpern QC first addressed whether hindsight should be taken into account. In doing so, he distinguished between two types of hindsight: the first being unexpected events that occurred after the making of the loan, such as the borrower

Any comments or queries?

Alexandra Anderson
Partner
+44 20 3060 6499
alexandra.anderson@rpc.co.uk

Helene Lee
Senior Associate
+44 20 3060 6185
helene.lee@rpc.co.uk

winning the lottery; whilst the second related to events that merely confirmed trends already apparent at the date of the loan. He concluded that the second form of hindsight should be taken into account in assessing the value of the borrower's covenant, following previous authorities on that issue.

As to how to assess the value of the borrowers' covenant, the claimant submitted that the test should be simply whether the borrowers were in "substantial arrears". Mr Halpern QC rejected that argument, stating that such a test would "merely substitute an unclear formula for that laid down by Lord Nicholls" and that it would result in difficulty over what was meant by "substantial". The judge also rejected the defendant's submission that it would be inferred that the covenant was worthless on the basis of a single missed payment. Instead, he carried out a detailed evaluation of the facts.

He accepted the claimant's submission that, prima facie, the borrowers' covenant was worth at least the shortfall between the security and the outstanding loan on the first day of the mortgage, because repayments were made for almost a year after the loan was made. The burden of proof then shifted to the defendant to prove otherwise. Following a detailed consideration of the borrowers' repayment history, Mr Halpern QC concluded that the borrowers' covenant was not worth the shortfall between the value of the security and the sum outstanding on the loan by early February 2007. In reaching this view, he saw the borrowers' first failure to make a repayment in February 2007 as significant because, although repayments were made after February 2007, the payments were not "duly" made, in that they were made irregularly and not always for the full amount due. He concluded that the subsequent bankruptcies "merely confirm a pattern which was readily apparent at least by early 2007".

On this basis, the claim would be statute barred, having been issued in October 2013. Mr Halpern QC nonetheless went on to consider the expert evidence, in case his conclusion on the facts was wrong.

He decided that the defendant's expert evidence from a chartered accountant was admissible, despite the Claimant's challenge that the evidence should have been from a mortgage lending expert. In doing so, he noted that: he had not been given any evidence that there was a "recognised method of valuing the personal covenant of a mortgagor"; chartered accountants are governed by rules of conduct designed to promote honesty and competence; and although the expert's evidence might not amount to a valuation of the covenant, the evidence was clearly relevant and essential ingredients for reaching a valuation, and Mr Halpern QC was thereby assisted by hearing his evidence.

The judge also observed that the expert had sought to ascertain the position regarding the borrowers' covenant with "very limited information", and that the claimant was presumably in a position to have provided further information, but had failed to do so. The expert's evidence was that:

- the borrowers' only source of income was from their building company, which was insolvent by 2004, the position worsening in 2005 and 2006. In short, the borrowers could not draw any income from that source during the life of the loan
- by March 2006, the borrowers' known assets and liabilities comprised £28,130 in cash. Their only known assets were a property and a boat, both of which were mortgaged. As the expert did not know whether these assets were in positive or negative equity, he treated them as having a £nil value. The expert then deducted the borrowers' mortgage liability and their

weekly expenditure (as estimated by the expert), which resulted in a net covenant value of £8,034 as at March 2006.

The claimant challenged the expert's assumptions about the property and boat, submitting that these assets might be more valuable. There was some evidence on the potential value of these assets, which Mr Halpern QC considers in his judgment. However, his conclusion was that, whilst the position was not clear-cut, he did not regard the points as undermining his overall confidence in the expert's evidence.

In consequence, Mr Halpern QC concluded that the defendant had discharged the burden of showing that damage had accrued in March 2006 because the value of the borrowers' covenant, of £8,034, was insufficient to bridge the shortfall between the value of the security and the amount outstanding on the loan. He noted that, even if he was wrong in arriving at the conclusion that the damage accrued in March 2006, he was further satisfied that the borrowers' covenant was not sufficiently valuable to bridge the gap in February 2007, or indeed June 2007, as a result of which the claim would be time barred in any event.

Whilst a failure by a borrower to make regular repayments under a loan may indicate that their covenant can no longer be considered valuable, what this case shows is that courts are reluctant to be drawn into formulating shortcut "tests". Accordingly, it remains the case that each case will turn on a detailed analysis of its own particular facts. Having said that, courts will take a recurring history of default into account when valuing a borrower's covenant and this may assist valuers to persuade a court that a claim is time-barred. In this case, unusually, liability was admitted and therefore limitation was the key issue between the parties. Indeed, it is the key issue in many of the claims currently coming before the courts and defendants and their insurers should look carefully at the history of the loan, to ensure there is no defence to the claim on the basis that time has expired.

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15199

Tower Bridge House
St Katharine's Way
London E1W 1AA
T +44 20 3060 6000

Temple Circus
Temple Way
Bristol BS1 6LW
T +44 20 3060 6000

11/F Three Exchange Square
8 Connaught Place
Central Hong Kong
T +852 2216 7000

8 Marina View #34-02A
Asia Square Tower 1
Singapore 018960
T +65 6818 5695