REFINANCING AND THE LAW OF (UN)INTENDED CONSEQUENCES

An article considering two recent professional negligence cases, *Swynson v Lowick Rose [2017] UKSC 32* and *Tiuta International Ltd v De Villiers Surveyors Ltd [2016] EWCA Civ 661*. It considers the apparent tension between the decisions and examines the consequences of the loan refinancing which took the form of an entirely new loan being made.

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This article considers two recent cases in which loans have been refinanced, and examines the consequences of the refinancing on subsequent professional negligence claims. In both cases, the refinancing took the form of an entirely new loan being made (rather than further funds being drawn against existing security) but the outcomes were, certainly at first blush, notably different

In *Swynson v Lowick Rose [2017] UKSC 32*, the accountant defendants admitted negligence (at trial) but avoided liability, whereas in *Tiuta International Ltd v De Villiers Surveyors Ltd [2016] EWCA Civ 661*, the conclusion was that, if the defendant valuers were negligent (which had yet to be determined), they would be liable for the whole of the losses incurred.

THE FACTS

The facts can be stated quite briefly, as the cases have been considered in *Legal updates, Court of Appeal wrong to apply principle of collateral benefit to allow party to recover damages for loss that had been avoided (Supreme Court)* and *Court of Appeal overturns summary judgment in claim based on negligent valuations.*

In *Swynson*, the original loan was made by a Mr Hunt, but through his company Swynson. The borrower got into difficulties and Mr Hunt advanced two further tranches of money through Swynson. Eventually the deal was restructured and Mr Hunt lent sufficient funds directly to the borrower to enable it to repay to Swynson the first and second advances. At trial, the accountants who had carried out due diligence on the borrower admitted negligence. The original loan had been made in reliance on their report and the second and third loans had been made in order to mitigate the losses being suffered as a result.

In *Tiuta*, the claimant advanced funds to a property developer in reliance on a valuation provided by the defendant. It subsequently agreed to make further funds available. Rather than simply advancing the additional funds required by way of varying the original agreement, the further advance was made by way of a fresh loan under which the borrower drew down sufficient funds to repay the original loan and then further funds when required. There was a dispute as to whether the original loan was, in fact, discharged but it was assumed, for the purposes of the application and the appeal, that the claimant's case was correct and the original loan had been discharged. A further valuation was obtained from the original valuers, the original charge by way of security was released and a new charge executed and registered.

The claimant did not allege that the original valuation had been negligent. Its case was that the final valuation had been negligent and it claimed the whole of its loss: even the part of it used to repay the original loan which, in reality, had already been advanced against the non-negligent valuation. The defendant valuers applied for summary judgment in respect of that part of the claim by which the claimant sought to recover the amount of the original advance.

THE DECISIONS

In *Swynson*, the trial judge held that the accountants did not owe a duty of care to Mr Hunt. There was no appeal against that decision. The trial judge and the Court of Appeal held that the payments by Mr Hunt to the borrower, and the discharge of the loans made by Swynson, were *res inter alios acta* and did not prevent Swynson from recovering damages from the accountants.

The Supreme Court disagreed, noting that the loss claimed was the amount lent under the original loan (in reliance on the negligent valuation) and the amounts lent under the subsequent advances (in a reasonable but unsuccessful attempt to mitigate), but that in fact that loss had been made good when the borrower repaid Swynson using the advance it received from Mr. Hunt. The net result was that neither Mr. Hunt nor Swynson could recover in respect of the losses caused by the accountant's negligence.

In *Tiuta*, the first instance judge gave judgment for the defendant in relation to that part of the claim which represented the original advance. This was on the basis that, even if the second valuation had been negligent, the claimant had suffered no loss (save for the additional, new amount advanced) as a result of it, because it had already advanced (and lost) the original sum in reliance on the non-negligent valuation. The Court of Appeal disagreed and reinstated the part of the claim which had been dismissed.

APPARENT TENSION

At first blush, it might appear that there is a tension between the two decisions. Assuming (which had not yet been decided, but had to be assumed for summary judgment purposes) that the second valuation in *Tiuta* was negligent, as alleged, then:

- In *Swynson*, the effect of the restructuring was that the defendant accountants avoided entirely a liability for a loss for which (prior to the restructuring) they probably had no defence.

- In *Tiuta*, the defendant valuer will be liable for losses which, as a matter of financial reality, the claimant had already sustained before the negligent valuation was provided.

SIGNIFICANCE OF THE STRUCTURES USED

The apparent tension between the two decisions can, however, be reconciled by a careful consideration of the structures used.

- In *Swynson*, the loan by Mr Hunt was made on terms that specified and required that it should be used to discharge the original two loans made by Swynson. It is, therefore, easy to see why the Supreme Court concluded that Swynson had no remaining loss to claim. Swynson had been repaid by the borrower. This may have been with money provided by Mr Hunt, but the defendant did not owe a duty of care to Mr Hunt.

- If Mr Hunt's money had been injected into Swynson by some other method, such as a loan to Swynson (considered by Lord Sumption at paragraph 13) or a gift to Swynson (considered by Lord Mance at paragraph 48), the reality would have been that the original loans were not repaid. The claim against the defendant would not have been affected. This would have achieved Mr Hunt's aim of clearing up the balance sheet. It might have been more difficult to achieve the additional aim of resolving the tax position of Swynson, but that would have been a small price to pay for retaining the benefit of the claim against the negligent accountants.

- In *Tiuta*, if the further advance had been structured as a simple further advance of additional funds secured by the same charge, then there would have been no claim in respect of the sums advanced in reliance on the original valuation.

- Because the funds were, in fact, advanced by way of an entirely new loan, which was (or for the purposes of the application and appeal was assumed to have been) used in part to discharge the original lending entirely, the claimant had recovered the money originally lent. When it made the new advance in reliance on the (allegedly) negligent valuation, it (in effect) relented the original advance with the addition of the further advance, but the whole loan was made in reliance on the second valuation. The Court of Appeal decision appears both logical and sound because the original lending (like Swynson's original lending) was, in point of fact, repaid. What remained outstanding was the whole of the loan made in reliance on the (allegedly) negligent valuation. As Moore-Bick LJ observed, the defendant's argument failed to take into account the fact that the "transaction was structured in such a way that the second loan was used to pay off the first" (*Tiuta, paragraph 17*).

LESSONS TO LEARN

What these decisions undoubtedly show is that courts will look at the reality of the financing structures used in similar cases. As Lord Neuberger pointed out, "the fact that a transaction could have been differently arranged does not mean that it must have the same consequences as if it had been differently arranged" (*Swynson, paragraph 100*). This reinforces the importance of two factors:

- At the time of any restructuring or refinancing, those advising parties need to pay careful consideration to the terms of any refinancing to ensure that claims (or potential claims) are not prejudiced.

- In responding to any subsequent litigation, professional advisers need to be equally careful to consider the terms of any restructuring which might affect issues of quantum or liability.

In *Swynson*, Mr Hunt was aware of the possible claim against the defendant before he lent money to the borrower. He was advised by his accountant in relation to the restructuring. By lending money to the original borrower which was used to pay off the first two loans made by Swynson, Mr Hunt achieved his accounting aims, in that Swynson's balance sheet was cleared up and the income tax problem which had occurred when Mr Hunt made the third advance was removed. But structuring the injection of money to achieve these aims as a loan to the original borrower meant that the claim against the negligent accountants was lost. Clearly this was not what Mr Hunt intended, and one can only wonder whether a claim against the accountants (or any others involved in the restructuring) will follow.

In *Tiuta*, however, the structure adopted meant that the lender was able to maintain a claim for damages based on the whole amount of the final advance, even though it had, in reality, already parted with the vast majority of that money before it received the (allegedly) negligent valuation.

It is interesting to note that the Court of Appeal decision in *Swynson* was relied upon by the defendant in *Tiuta*. The Court of Appeal in *Tiuta* concluded that, even though the Court of Appeal in *Swynson* had, in effect, disregarded the fact that the effect of the loan by Mr Hunt was to allow the original borrower to discharge the relevant part of the original debt in full, that decision was "not authority for the proposition that the court is entitled to disregard the structure of a routine refinancing transaction in favour of what it regards as the substance of the case" (*Tiuta, King LJ at paragraph 36*). The decision of the Supreme Court in *Swynson* serves to reinforce the conclusion that the court cannot and will not disregard the actual structure adopted and the actual consequences of it.