

CASENOTE:

by Steve Bonutto

In a nutshell: A clear view on assessing damages in 'no transaction' cases

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The decision of Chesterman J in *Moloney & Anor v Bells Securities Pty Ltd & Ors* [2005] QSC 013 in the Queensland Supreme Court Trial Division has provided a concise analysis and application of the assessment of damages in 'no transaction' cases. The case also illustrates the evidentiary hurdles facing a plaintiff in proving liability and quantum in such cases.

The parties

The first defendant (Bells Securities) carried on the business of private mortgage lending and raised moneys for each loan by obtaining varying amounts from various clients (contributors) of the second defendant (Bells Solicitors). The directors and shareholders of Bells Securities also constituted Bells Solicitors, which was responsible for preparing loan documentation and making investigations into the value of proposed securities.

On May 14, 1999, Bells Securities lent \$1,040,000 to Longhampton Pty Ltd, such moneys having been made available by various contributors. The loan to Longhampton was for a term of 12 months, but repayment was not made. The property interest taken as security for the loan was worth less than the advance, and there was a subsequent loss of principal and interest.

Due to subsequent legislative amendments, Bells Securities' money-lending business was considered to be a "managed investment scheme" for the purposes of Part 5C of the *Corporations Act* 2001 (Cth). Bells Securities chose to discontinue the business rather than seek registration.

On June 6, 2002, the Supreme Court of Queensland appointed the plaintiffs (Moloney and others) as liquidators to wind up the scheme. Thereafter, the plaintiffs commenced an action against Bells Securities and Bells Solicitors for damages for negligence, breach of retainer and contravention of Section 52 of the *Trade Practices Act*, being the equivalent of the lost principal, interest and realisation expenses that were unable to be recovered from Longhampton.

Bells Securities and Bells Solicitors joined two valuers (Collins and MCH) as third parties, alleging that the loan was made in reliance upon their valuations that the subject security was sufficiently valuable for the purpose of the advance.

The valuations

His Honour found that Collins valued the unencumbered freehold interest in the land on February 4, 1999, at in excess of \$1,500,000 (the Collins valuation). However, one month later, Longhampton entered into a five-year lease of the property. Bells Solicitors was aware of the existence and the terms of the lease at the time of considering the proposed advance. Bells Solicitors requested and received an assignment of the Collins valuation. Additionally, Bells Solicitors instructed MCH to carry out a "desktop

check valuation”, that is a review and verification of the Collins valuation.

After an extensive review of the evidence, his Honour was satisfied that Bells Solicitors did not ask Collins or any other valuer to provide a valuation of Longhampton’s proposed security interest as lessor in the land, namely Longhampton’s right to receive rent and the reversion (which was worth between \$900,000 to \$1,100,000). Additionally, his Honour expressly found that Bells Solicitors did not advise MCH of the existence of the lease.

Decision – Liability in the principal proceedings

Bells Solicitors was negligent in failing to obtain an appropriate valuation of the proposed security and otherwise failing to advise Bells Securities whether the loan met its prudential lending requirements. Further, his Honour found that Bells Securities failed to take reasonable care for the preservation of the trust fund constituted by the contributions. His Honour was satisfied that the transaction would not have occurred but for the negligence of Bells Securities and/or Bells Solicitors.

Decision – No liability in the third party proceedings

His Honour found that Bells Solicitors did not advise MCH of the existence of the lease. MCH was instructed only to carry out a “desktop check valuation” of the Collins valuation, and that the MCH valuation was appropriate in the circumstances. In any event, his Honour found there was no reliance by Bells Securities and/or Bells Solicitors upon the MCH valuation.

As regards the Collins valuation, the critical issue was the contents of a conversation between Bells Solicitors and Collins on April 19, four days after it had been assigned to Bells Securities, namely as to whether Collins was made aware of the existence of the lease and the impact upon the Collins valuation.

After a lengthy analysis of the evidence from both parties, his Honour found he was unable to conclude what was actually said in relation to the lease and its effect on the valuation. As a result, the claim against Collins failed for lack of proof.

Assessment of damages

The plaintiffs claimed in respect of the principal the amount being the difference between the amount due under the loan agreement at the date of sale and the amount recovered, after expenses from the sale of the property. This amount included interest at 14.5% per annum compounding monthly (effectively the ‘default’ rate set out in the loan agreement).

His Honour summarised the relevant law as:

(a) Where a party makes a contract by reason of another’s negligent misstatement or failure to advise, whether the cause of action be in negligence contract or contravention of the *Trade Practices Act*, the measure of damage is not the loss of the bargain the contract would have yielded, but the cost to the Plaintiff of making the contract;

(b) Recent High Court decisions in *HTW Valuers*

(*Central Qld) Pty Ltd v Astonland Pty Ltd* [2004] HCA 54 and *Henville v Walker* (2001) 206 CLR 459 show that there is no rigid formula which will determine how to assess damages in every case. Instead, a degree of flexibility is required so that the damages assessed are apposite to the circumstances of the case;

(c) The ‘contractual’ measure of damages, that is an award of the profits the plaintiff would have made from entering a contract, is inapplicable in circumstances where, had a defendant not contravened the statute or been negligent, the plaintiff would not have made the contract. In ‘no transaction’ cases, the assessment rather depends upon the extent to which the plaintiff is worse off as a result of entering the contract which, on the relevant hypothesis, he did because of the negligence or statutory contravention.

Applying the above principles, the plaintiffs were entitled to recover the difference between the amount of the advance and the amount recovered from the sale of the security, together with appropriate expenses incurred in realisation.

His Honour specifically rejected the claim for compound interest, noting that such interest ought only be awarded where there is a contractual basis for it, or against a defaulting trustee guilty of serious misconduct, or in circumstances prescribed in *Hungerfords v Walker* (1989) 171 CLR 125. What the contributors lost was not the amount payable under the mortgage, but a lost opportunity to invest elsewhere.

As was noted by McHugh J in *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109 at 147: “The opportunity cost of lending the principal sum . . . was the interest that it was deprived of in not being able to lend that principal to another borrower . . . And it was the opportunity cost, not the interest that [the borrower] failed to pay, that was the relevant loss for the purpose of Section 82.”

His Honour found that there was no evidence led by any of the contributors as to what they would have done with their money had they not lent it to Longhampton. Accordingly, the rate should be modest, reflecting a guaranteed return such as bank deposits or government bonds, and was awarded at 5 percent.

Implications

1. His Honour’s decision provides a commonsense approach to the assessment of damages in ‘no transaction’ cases by focusing upon the extent to which the plaintiff is truly worse off as a result of entering into a contract due to alleged negligence or statutory contravention.

2. The case demonstrates the importance of assessing the ‘opportunity cost’ sustained by lenders and rejecting claims for compound interest save in limited circumstances. This will pose particular difficulties for private mortgage lenders acting on behalf of various contributors.

3. Finally, the failure of the claims against the valuers underlines once again the need for rigorous forensic examination of the facts alleged to establish reliance in claims for negligent misstatement or statutory contravention. *