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EUROPEAN REAL ESTATE SOCIETY

BERLIN - JUNE 25TH TO 27TH 1997

Contributory Negligence Involving Overseas European Banks in Property Valuation Negligence Cases In The UK

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Key-words

European property, bank lending procedures, professional liability, negligent valuations.

Abstract

This paper examines the phenomenon of cross-border property lending and examines a number of issues regarding lending procedures and decision making processes in the context of the relationship between lender and professional advisor.

It commences by placing these procedures and processes in the context of the development of cross border European property investment and finance. The UK has been a popular destination for overseas investors and lenders over the last decade and is therefore used as a case study to examine the additional institutional risk that overseas lenders may face when operating outside of their own country and obtaining advice from home professionals.

The UK market was the subject of a boom period during the late 1980s, followed by a recession in the early 1990s. The losses triggered a number of professional negligence actions by lenders against valuers. These include a number of overseas lenders mainly from Europe and these cases have been examined for any particular features which, coupled with other data gained from overseas lenders as part of an interview survey, could be used to isolate any significant problems for European lenders in overseas markets..

The research identified a lack of clarity in roles and relationships between lender and advisor, difficulties in communications both internally and between overseas branches and headquarters and failures in provision and interpretation of advice. The paper concludes by identifying the issues which may need to be addressed generally by lenders and their advisors, when the lenders are operating in overseas markets.

1. Aim, Objectives and Methodology

During the 1990s, there has been a substantial increase in the number of reported and unreported cases in the UK of lenders suing valuers for alleged negligent valuations and a number of these cases involved overseas lending institutions, including mainland European lenders. The objectives of this paper are to examine the incidence, sources and trends in European cross-border real estate investment and lending on property transactions, to compare them with the cases involving home or overseas lenders against valuers in the UK and to identify any particular or significant features which may be contributing to the occurrence of these cases. The aim of the research is to identify any issues which could be addressed between overseas lender and valuer to diminish the chances of the transaction ending in a professional liability action. Although the paper concentrates on cross border lending in Europe, the issues identified are seen as having wider international implications.

The research undertaken in order to achieve these aims and objectives can be divided into three main sub-areas, comprising literature and other sources, structured interviews with selected lenders and a content analysis of decided negligent valuation cases in the UK.

The first stage of the research was an examination of the phenomenon of cross-border investment in and lending on real estate in Europe to illustrate the sources and trends. As the main analysis of the legal issues was based on the experience of overseas lenders in the UK, the background contextual information concentrated on flows of finance into the UK. The sources on cross border real estate investment, particularly overseas bank lending, within Europe are poor and a true and accurate picture is difficult to draw. However, this information is only required to place the main body of the paper into context and past and present trends within Europe are clearly identifiable from the existing data. This data shortage is very apparent from the most recent research by the Economist Intelligence Unit (1997) into Foreign Direct Investment commissioned by the UK based Royal Institution of Chartered Surveyors

This paper also draws on information obtained as part of another project reported in two working papers (Crosby, et.al., 1997a; 1997b). Survey work for that study included four overseas banks, two European and two Asian, who took part in a series of structured interviews designed to obtain more detailed information on lending practices, particularly in relation to selection and instruction of, and reliance on, valuers to advise on the adequacy of property as security. The responses given were capable of being compared, and, in some instances, contrasted, with those given by their local equivalents, in this case five UK lenders. This research examined the whole loan valuation process including bases of valuation and reporting of values.

The main phase of the research for this paper was a detailed study of those cases where risk exposure issues would be expected to be most acute, namely, where losses had been sustained as a result of property finance transactions. Previous research resulted in the development of an extensive database comprising all the reported and many unreported decisions of the courts in professional negligence cases concerning valuers and other property professionals. The cases in question derive chiefly from the UK, although there are significant numbers of cases from Commonwealth countries such as Australia, New Zealand and Canada. A number of these cases involve lenders from overseas and property professionals from the UK.

Accordingly, the research team carried out an analysis of decided negligence cases involving property lending in the UK since two landmark cases occurred in 1977. Forty-eight cases have been decided in the period 1991 to 1996, representing valuations of commercial and residential property carried out in the UK from 1983 to 1991. The incidence of overseas banks in these cases was compared to the incidence of overseas bank lending in the UK real estate market. The search was then refined to identify those cases involving overseas, mainly European, lenders. Special attention was paid to those cases where allegations by the lender against local consultants were met by

counter-allegations of negligent lending practice on the part of the plaintiffs, so as to amount to an arguable defence of contributory negligence.

The cases extracted were examined in detail to identify common features and trends, including any consistency or otherwise with equivalents involving UK lenders. The evidence of attitudes on the part of overseas banks obtained by the structured interviews was utilised to assist in this stage.

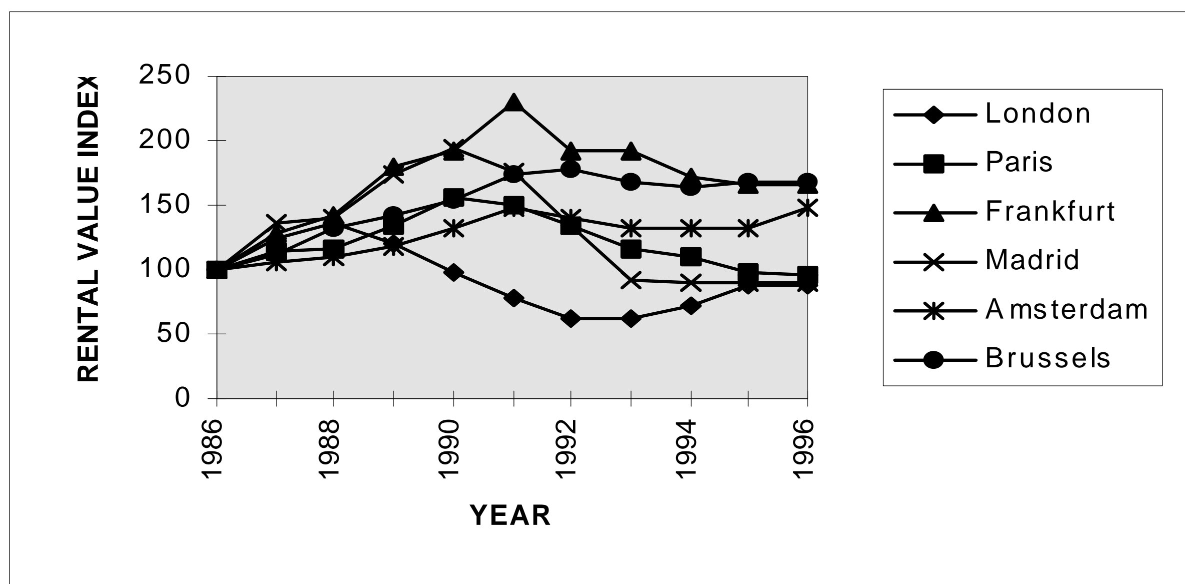
The analysis of the evidence obtained by the methods described above enabled the authors to proceed to the conclusions set out in Section 5 below. The findings themselves are set out and discussed in Sections 2 to 4.

2. The Market Context

2.1 Cross-border real estate investment

Property markets in the 1980s and 1990s have performed similarly in many countries and regions of the world, not just Europe. The long term rising market in rental values in the 1980s was followed by recession in the 1990s. Figure 1 illustrates that general trend for the market in offices in six major centres in Europe.

Figure 1. Rental Values in Six Major European Centres - Offices End 1986 - End 1996



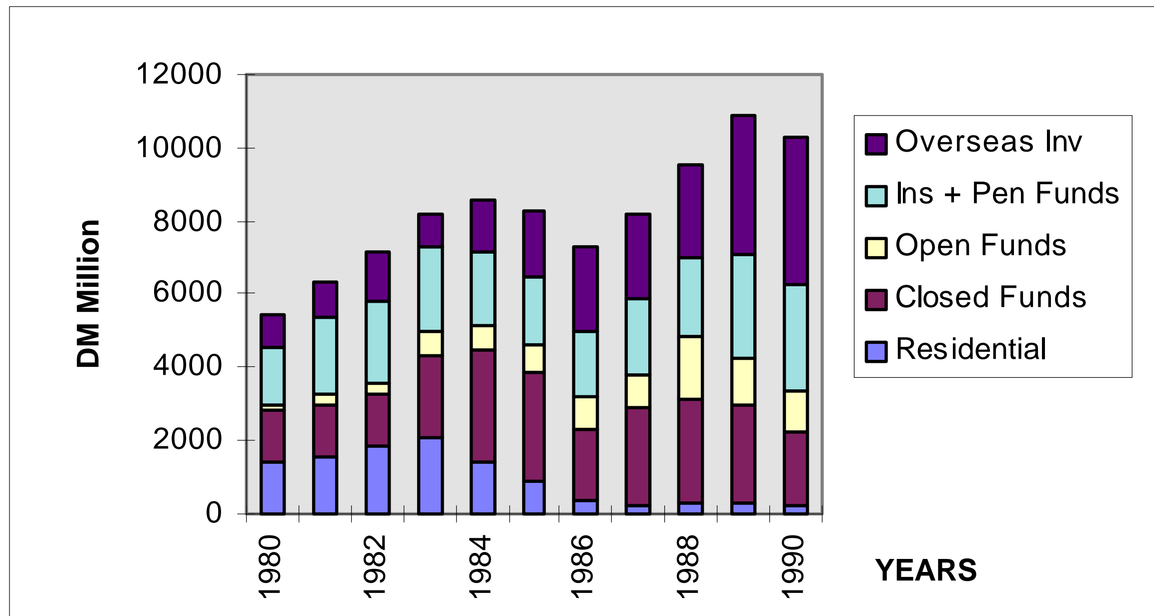
Source (Various Reports from DTZ Debenham Thorpe, JLW and Healey and Baker and Euro Property).

All six centres suffered nominal falls in rental values between the end of 1989 and the end of 1993, commencing with London and finishing with Brussels. Capitalisation rates also moved upwards exacerbating any capital value reductions caused by rent reductions. The central London monthly office capital value index almost halved between the end of 1989 and 1992 (IPD, 1992).

The boom of the late 1980s, followed by the recession in the early 1990s, coincided with an increase in the total new money being invested into investment property. In the UK, this was around £4 billion in 1986, rising to around £8 billion in 1987, over £10 billion in 1988, peaking at £14 billion

in 1989 (DTZ, 1996a). In Germany, the commercial property investment market increased from DM 5.4 billion in 1980 to nearly DM11 billion in 1989 (see Figure 2.).

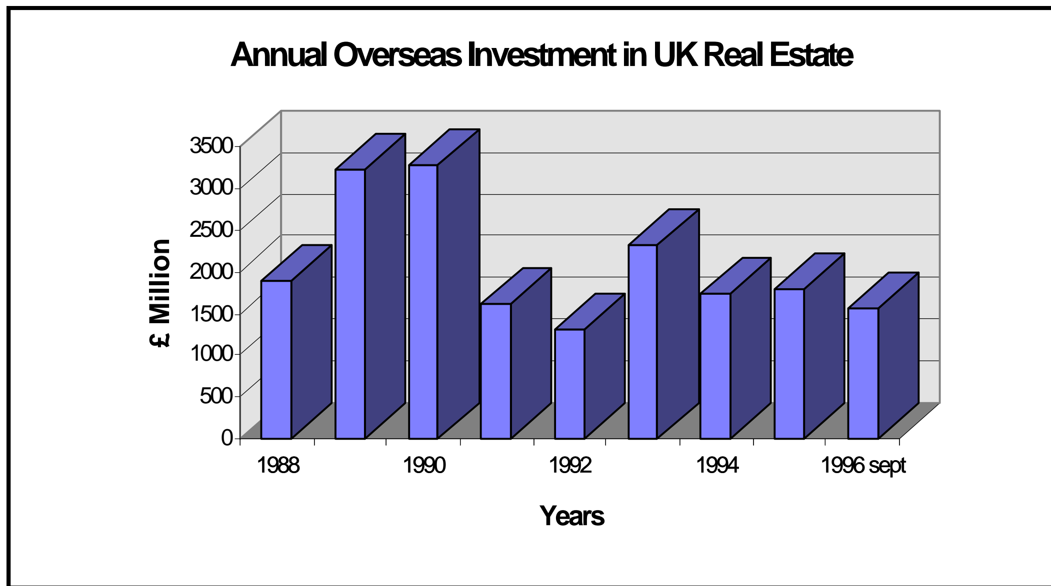
Figure 2. Annual Turnover German Commercial Property Investment Market 1980-1990



Source (JLW, 1991)

A significant feature of many investment markets in the 1980s was the increasing amount of cross border investment. In the UK, the level of inward investment by overseas residents rose from £4.5 billion in 1985 to a peak of £18.5 billion in 1989 and 1990. Property shared in this new phenomenon; overseas investment in UK property took off in 1988, rising from around £250 million in 1987 to nearly £2 billion in 1988 and over £3 billion in 1989 and 1990 (DTZ, 1996a). Figure 3. illustrates the overall level of overseas investment in the UK property market for the period 1988 to 1996 (Sept) and shows that the amount has levelled off during the 1990s at between £2 and £3 billion per annum.

Figure 3. Annual Overseas Investment in UK Real Estate 1988-1996



Source : DTZ Debenham Thorpe Research UK (DTZ, 1996b)

In Germany, overseas investors contributed nearly DM1.5 billion in 1985 rising to DM4 billion in 1990. A significant portion of these overseas funds came from Sweden in the the late 1980s and the Japanese were the heaviest non European investors. A survey by the Munchener Institute reported in JLW (1991) estimated that DM16 billion of real estate owned by overseas investors in 1990 was shared as in Table 1.

Table 1 - Breakdown of German Real Estate Owned by Overseas Investors 1990

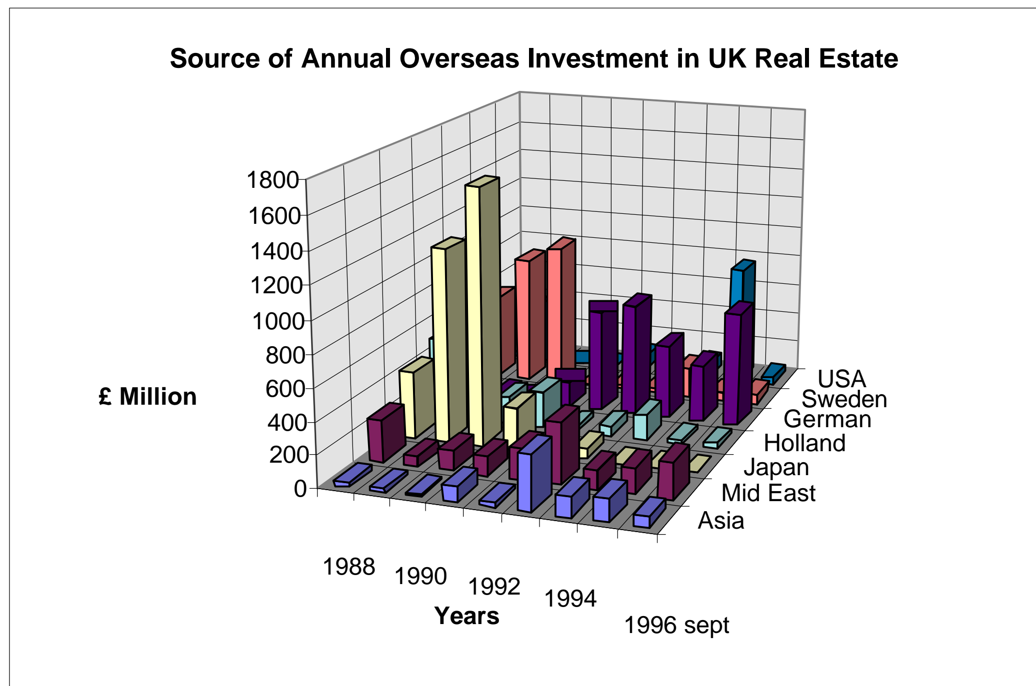
	DM Billions
Scandanavia (chiefly Sweden)	5.5
Netherlands	4.0
Great Britain	2.5
Japan	1.5
USA	1.0
France	0.5
Near East	0.5
Other	0.5

Source : JLW (1991)

This indicates that the Dutch were also active in overseas markets in the 1980s. By November 1994, Dutch property holdings in Europe totalled DFI 13.05 billion; 34% in Germany, 26% in the UK, 25% in France and 10% in Belgium. Overseas property holdings in the Netherlands totalled DFI 6.9 billion; 58% held by Scandanavian countries and 26% by Germany (Dijkstra, 1995).

These major sources of cross border activity are mirrored in the UK. Figure 4. illustrates that, in the late 1980s, the main overseas investors were from Sweden and Japan, investing around £2.3 billion and £3.2 billion respectively in the period 1988 to 1990. Dutch investors were active in 1988 with £500 million purchased but withdrew before the Japanese and Swedes. However, from 1992 onwards, the Germans dominated overseas investment, nearly £3 billion being invested between 1992 and September 1996. The large USA investment in 1995 was the result of the purchase of Canary Wharf in London's Docklands.

Figure 4 Sources of Annual Overseas Investment into UK Real Estate 1988 - 1996



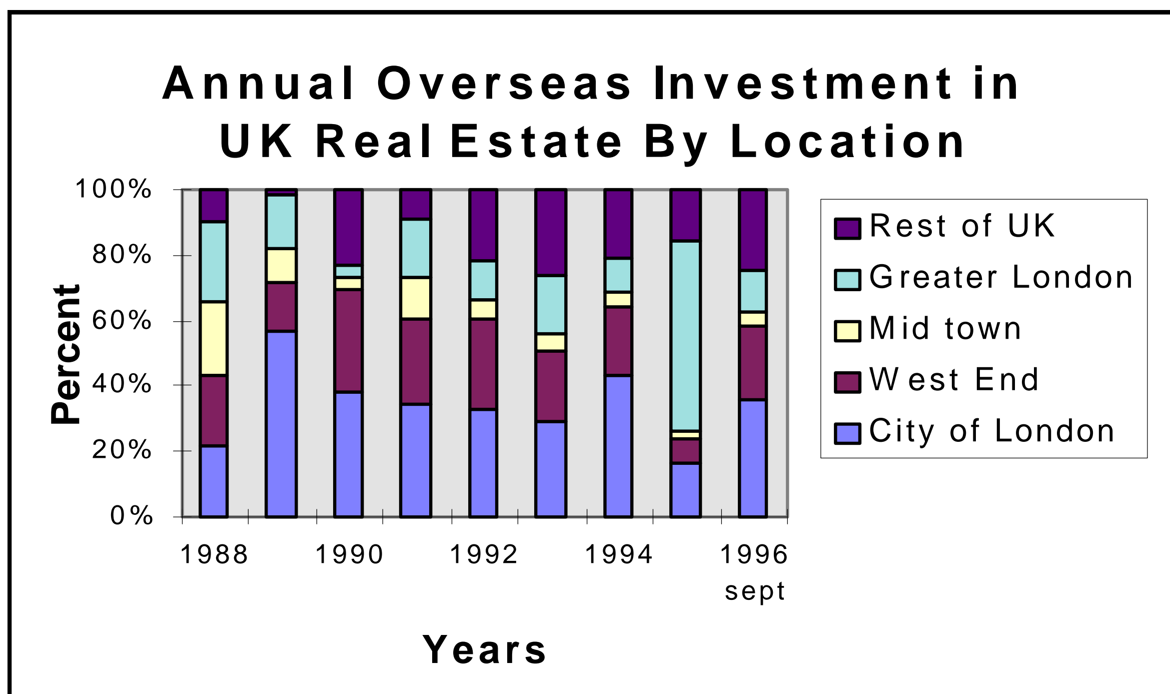
Source : DTZ Debenham Thorpe Research UK (DTZ, 1996b)

In the UK, overseas investors have tended to concentrate on London, which accounts for over 80% of investment since 1988, the majority in the City, West End and Mid Town core markets. The exception in 1995 relates again to the Canary Wharf purchase in Docklands (Figure 5.). JLW (Solomans, 1995) estimate that, between 1990 and 1994, German investment in central London totalled £2 billion as set out in Table 2.

Table 2 - German Investment in Central London 1990 - 1994 (£Million)

Year	Private Sources	Institutions	Banks	Total
1990	24	12	36	**72**
1991	53	91	36	**180**
1992	303	157	162	**622**
1993	403	183	80	**666**
1994	173	316	37.5	**526.5**
Total	**956**	**759**	**315.5**	**2030.5**

Figure 5. Annual Overseas Investment in UK Real Estate by Region



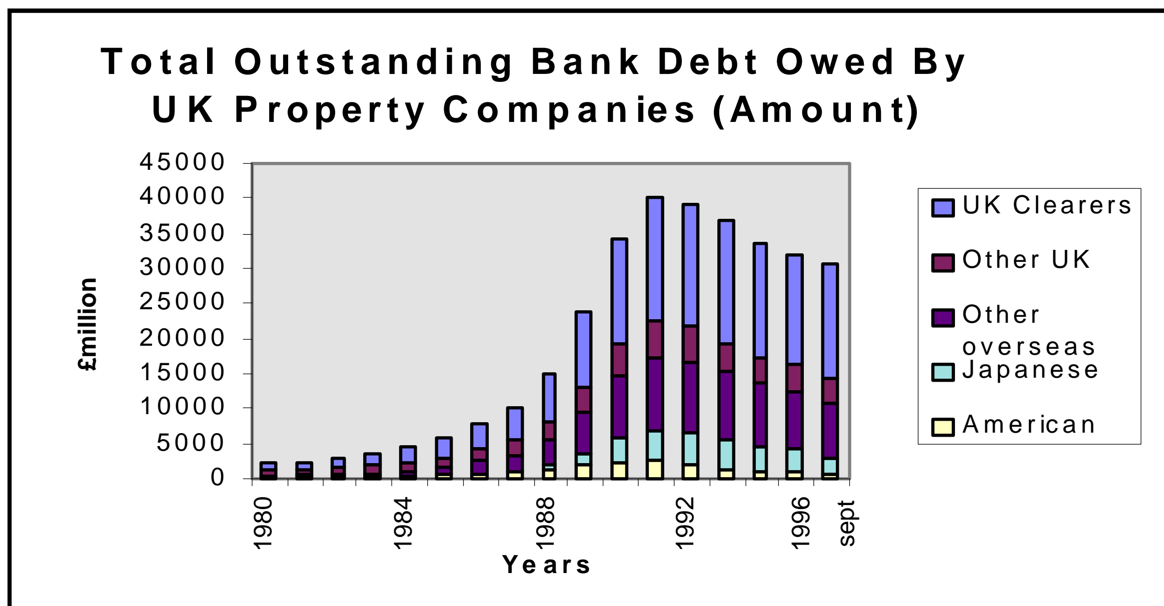
Source : DTZ Debenham Thorpe Research UK (DTZ, 1996b)

2.2 Cross-border real estate lending

The increase in overseas activity in the real estate market has seen a corresponding increase in the number of overseas banks locating in London. In 1980, there were 71 US banks, 141 European Banks, 24 Japanese and 147 other overseas banks located in London. By 1990, this had increased to 53 US, 207 European, 51 Japanese and 167 other overseas. Over the period, 245 new banks had set up offices with only 132 closing down, some the result of mergers (Beardsley, 1996). By 1990, there were a total of 478 overseas banks represented in London.

Outstanding bank debt owed by UK property companies increased from £2.2 billion in 1980 to a peak of £40 billion in 1991, before reducing to the current amount of £30 billion in September 1996 (Figure 6.).

Figure 6 : Total Outstanding Bank Debt Owed by UK Property Companies



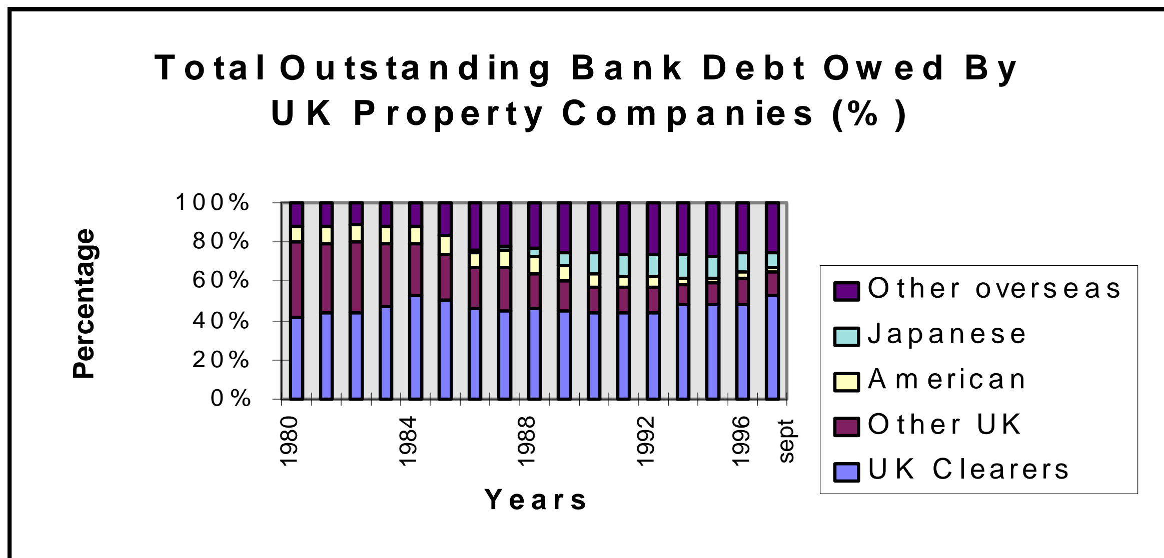
Source : DTZ Debenham Thorpe Research UK (DTZ, 1996b)

In France, Morling (Rowe, 1997) estimated that outstanding bank lending to property totalled FFR315 billion in 1995, having reduced from FFR350 billion in 1994 and FFR375 billion in 1993.

European Mortgage Federation figures suggest that the outstanding loans against mortgages on commercial property between 1985 and 1993 increased by 125% in Belgium, 143% in Italy, 44% in Portugal, 202% in Spain and 42% in Greece. In Germany, the increase was 138%, while in the Netherlands it increased by 53% between 1985 and 1989, before falling back 25% to 1993 (RICS, 1995).

Despite the different kinds of lending included in the various national figures, it is clear that the exposure of international lenders to the property sector increased during the 1980s. In the UK, only 20% of the outstanding property company debt was owed to overseas banks in 1980 but, by 1990, this had increased to 43%. They have since reduced their exposure to 35%. Figure 7. illustrates the respective shares of the UK clearers, other UK banks, Japanese, US and other overseas banks.

Figure 7. Total Outstanding Bank Debt Owed by UK Property Companies 1980-1996



Source : DTZ Debenham Thorpe Research UK (DTZ, 1996b)

Given the importance of London in the property investment market in the UK, a Richard Ellis/Gallup (1995) survey of 62 overseas investors and 51 overseas banks canvassed their

perceptions and future intentions towards London. The prospects for the London market were very favourably viewed, with positive responses concerning rental and capital growth prospects, the importance of London as an international financial centre, UK economic growth prospects and the length of leases. A majority of investor respondents who expressed an opinion thought London would perform better than any other City in Europe and 61% said there was no other city in the world in which they would prefer to invest.

The bankers shared the view on the prospects of London but were more concerned with the stability of cash flow generated by the structure of leases in the UK. Investment and lending since the survey has tended to confirm those findings. International investment and overseas bank lending has continued during 1995 and the first three quarters of 1996.

The evidence suggests that overseas investment and bank lending on commercial property will continue to be a major factor in centres around the world, with London and the UK being a favoured home for some of these international funds. There have been some failures, most notably the Swedish and Japanese in the late 1980s, countered by some equally spectacular successes, most notably by the Germans in the over-rented London office market of the early to middle 1990s. This paper is more concerned with the repercussions of the failures.

These failures are not confined to Europe. It is estimated that by 1993 Japanese investors had a $77 billion exposure to the US real estate market. Kennedy and Matsuo suggest that the problems of Japanese investors stemmed from five factors; but that they all centred on:

> "an apparent lack of understanding or naiveté on the part of Japanese investors with respect to the US market. Many assumptions made by Japanese investors were predicated on an understanding of the domestic Japanese real estate market as opposed to the foreign market of US real estate.".
>
> (Kennedy and Matsuo, 1996, p9)

In addition to investment market risks, there may also be additional legal and procedural risks in investing or lending in foreign environments. A lack of detailed understanding of cultural, political, legal and social factors may lead to misunderstandings of, or undue reliance on, advice received from professionals operating within the particular market. These institutional risks can lead to 'Home Asset Bias' (Geurts and Jaffe, 1996; Uppal, 1992), investing in a home market rather than obtaining the diversification benefits of the overseas market because of the lack of knowledge of the institutional context of the country concerned. One such institutional factor is the ability of a client to sue a professional advisor and to claim damages for negligent actions. In the UK, this ability exists but exercising it has risks attached.

A number of overseas lenders, exposed to losses in the aftermath of the recession and the property crash, decided to try to recover their losses by claiming that they had been badly advised by the local market professionals carrying out property valuations prior to lending. By adopting this course of action, the banks' own processes and procedures were examined in the course of the hearings and revealed some interesting insights into the lending process. The remainder of this paper considers whether lenders have particular difficulties lending in overseas markets, beyond those lending in home markets, by examining the detail of these cases and comparing them with similar cases involving UK lenders. Conclusions can then be made regarding the particular steps which may need to be taken by overseas lenders to address any procedural problem, and so reduce the institutional risks of lending in overseas markets.

3. Incidence of Decided Cases

The history of institutional lenders suing valuers in the UK really started with the two landmark cases of *Singer and Friedlander Ltd* v *John D Wood & Co* [1977] 2 EGLR 84 and *Corisand Investments Ltd* v *Druce and Co* [1978] 2 EGLR 86. As with the recent spate of legal actions, both these cases arose in the aftermath of a slump in the commercial property market. The extent and duration of this slump in actual values was significantly less than the recession of the 1990s although in real terms it was similar. At such times, there is an obvious increased risk that the borrower may be over-exposed and may default in repayment of the loan; that the property will have fallen in value to a point where it provides insufficient security for the outstanding debt; and that the lender will then seek to recoup its losses by an action for negligence against the valuer on whose report the lender relied in agreeing to make the loan (Crosby, et.al., 1997a).

Between 1979 and 1990, a period of sustained (with a few very minor exceptions) period of value growth in all sectors of the UK property market, only 5 lender-valuer claims appear to have reached the courts. These were all concerned with valuations of residential property. They are *Anglia Hastings & Thanet Building Society v House & Son* [1981] 2 EGLR 17; *London & South of England Building Society v Stone* [1982] 1 EGLR 139, [1983] 3 All ER 105, [1983] 2 EGLR 131; *Testabridge Investments Ltd v David Restall & Associates* (1985, unreported); *Predeth v Castle Phillips Finance Co Ltd* [1986] 2 EGLR 144; and *Swingcastle Ltd v Alastair Gibson* [1991] 2 All ER 353, [1991] 1 EGLR 157.

From 1991 to the present time, a number of factors have combined to render litigation between lenders and valuers significantly different from that seen in the previous case law, to such an extent that this research is based exclusively on the cases decided during the later period.

Tables 3 and 4 set out the details of cases decided between 1991 and 1996 concerning commercial (Table 3) and residential (Table 4) property valuations carried out between 1983 and 1991.

Table 3 - Negligence Actions Involving Commercial Property

Date of valuation	Cases	UK lenders	European (+O/S) lenders	Contributory negligence	Cont Neg UK lenders	Cont Neg European (+O/S) lenders
1983	1	1	0	0	0	0
1984	1	1	0	1	1	0
1985	1	0	1	1	0	1
1988	5	2	2(+1)	3	1	2
1989	10	5	4	9	4	5
1990	4	1	1(+2)	4	1	1(+2)
1991	1	1	0	0	0	0
Total	23	11	9(+3)	18	7	9(+2)

Table 4 - Negligence Actions Involving Residential Property

Date of valuation	Cases	UK lenders	European lenders	Contributory negligence	Cont Neg UK lenders	Cont Neg European lenders
1987	2	2	0	0	0	0
1988	2	1	1	2	1	1
1989	8	7	1	2	1	1
1990	11	6	5	6	3	3
1991	2	1	1	0	0	0
Total	25	17	8	10	5	5

Fifteen out of 23 commercial valuation cases (65%) were carried out in the boom period of 1988 and 1989, while an additional four were carried out in the first year of the 'collapse' which is generally acknowledged to be the end of 1989. This illustrates a repeat of the 1970s scenario; loans and/or purchases made at the height of the 'boom', a loan default or other financial problem coinciding with the collapse of the market and then losses by the lender being exacerbated by difficulties of selling in weak economic conditions.

The peaking of the residential owner-occupied market in the UK is less easy to identify. An artificial stimulus was supplied during the spring of 1988 by the announcement that the Government

would change the tax status of mortgage holders in August of that year by reducing tax relief. Purchasers entered the market to beat the August deadline. Comments on the state of the residential market by expert witnesses within individual cases tend to suggest that the market weakened considerably after August 1988 but actual falls in value only became apparent from the middle of 1989 and, in some regions, even later. Although a considerable number of cases involved valuations in late 1989 and 1990, after the peak in the market, it is apparent that these cases represent valuations at levels which were perceived to be at or near the peak. The litigation cycle is therefore similar to the commercial cases.

It is noticeable that overseas lenders figure very strongly as a proportion of the parties concerned. Despite the fact that only around 40% of outstanding bank debt was owed to them by UK property companies from 1990 to 1996, overseas lenders were involved in over half the commercial property valuation cases (but only around 30% of the residential property cases). Moreover, of the 20 actions bought by overseas lenders, all but three concerned banks from mainland Europe.

Another feature worthy of comment is the number of cases concerning overseas institutions where contributory negligence was an issue. Again, it may be regarded as disproportionate when compared with the UK lender cases. Given that, until 1991, in the UK valuers had not run the defence of contributory negligence against lenders suing them (although it had been done in New Zealand over a decade ago in *Kendall-Wilson Securities* v *Barraclough* [1986] NZLR 576), it is surprising that as many as 28 out of 48 (58%) contain an argument of that defence. It is even more surprising that, in the cases involving overseas lenders, that figure is 16 out of 20 (80%), compared with 12 out of 28 (43%) in the cases involving UK lenders. This disparity is especially material in the residential cases; the proportions are less uneven in the commercial sector.

In fairness, it should be noted that the allegations of contributory negligence have only benefited the defence in eight cases out of 28 (29%) where they were made, resulting in reductions of between

15% and 30% of damages awarded. Of those eight, five concerned commercial property (*Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd* [1995] 2 All ER 769, [1994] 2 EGLR 108; *Nyckeln Finance Co Ltd v Stumpbrook Continuation Ltd* [1994] 2 EGLR 143; *South Australian Asset Management Corporation v York Montague Ltd* [1995] 2 EGLR 219; *Barclays Bank plc v William H Brown Ltd* [1996] NPC 184 and *Interallianz Finanz AG v Independent Insurance Co Ltd* [1997] NPC 89) and three concerned residential property (*BNP Mortgages Ltd v Key Surveyors Nationwide Ltd* (1994, unreported); *Platform Home Loans Ltd v Oyston Shipways Ltd* [1996] EGCS 146 and *Chelsea Building Society v Goddard & Smith* [1996] EGCS 157.).

More significantly, perhaps, five of the eight involved overseas lenders, four of them European. To these may be added four more where the judge held that the contributory negligence of the lender was sufficiently serious to justify holding the lender responsible for up to 80% of the loss (*Nyckeln Finance Company Ltd v Edward Symmons & Partners* (1995, unreported); *First National Bank plc v Andrew S Taylor (Commercial) Ltd* [1995] EGCS 200; *PK Finans International (UK) Limited v Andrew Downs & Co Ltd* [1992] 1 EGLR 172 and *Credit Agricole Personal Finance plc v Murray* [1995] EGCS 32. It was only the failure of the lender's claim that rendered these findings purely academic. In total, contributory negligence by the lender has been found to exist in 12 cases, eight involving overseas lenders, with seven of those from mainland Europe.

Table 5 sets out the grounds on which the contributory negligence defence was founded in the 28 cases and details the success or failure of the defence.

Table 5 : Contributory negligence (results and grounds)

	Total (1)		**Commercial (2)**		**Residential (3)**	
	Yes	**No**	**Yes**	**No**	**Yes**	**No**
Inadequate checks on borrower	4	13	2	8	2	5
Failure by lender to follow own rules	5	3	2	3	3	

Imprudent lending policy	1	3		2	1	1
Blind reliance on valuation	4	4	4	3		1
Other negligent conduct	2	1	2	1		
Total	**16**	**24**	**10**	**17**	**6**	**7**

Notes to Table 5

(1) Total number of cases 28 : Total of 40 in column 1 includes a number of the 28 cases where multiple grounds for contributory negligence were tested.

(2) Yes = Defence allowed No = Defence disallowed.

Table 6 sets out details of the eight cases where contributory negligence was allowed and the four additional cases where the judge stated that the defence would have been allowed had the valuer been found liable. It identifies the amount of the reduction in damages that was, or would have been, awarded and shows which of the cases involved European or other overseas lenders.

Table 6 : Contributory negligence : successful defences and reductions in damages

Grounds	**Cases where Contributory Negligence Allowed**								**Cases where Cont Neg would have been Allowed**			
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
Inadequate checks on borrower							*		*		*	*
Failure by lender to follow own rules			*	*		*	*				*	
Imprudent lending policy						*						
Blind reliance on valuation	*	*			*			*				
Other negligent conduct										*		
Percentage reduction	**30**	**20**	**25**	**25**	**25**	**20**	**25**	**15**	**15**	**80**	**75**	**75**
Mainland European (E) Overseas (OS) or UK lender	**E**	**E**	**E**	**OS**	**UK**	**UK**	**UK**	**E**	**E**	**E**	**E**	**UK**

As indicated in Table 5, more than one-half of all the cases in which contributory negligence has been pleaded (almost three-quarters in the residential field) contain the allegation by the valuer that

the lender failed to carry out a sufficient check on the creditworthiness of the borrower. However, such allegations in themselves have led to a finding of contributory negligence on only four occasions (two actual, two obiter). Such allegations are frequently based on evidence that the lender was actually aware of facts concerning the borrower which, it is claimed, should have prompted further enquiries. It has also been argued that, where solicitors acting for the lender are aware of such facts, their knowledge should be attributed to the lender, for the purpose of establishing contributory negligence. However, while two judges appear to have accepted that knowledge may be imputed in this way in *HIT Finance Ltd v Lewis & Tucker Ltd* [1993] 2 EGLR 231 and *Axa Equity & Law Home Loans Ltd v Goldsack & Freeman* [1994] 1 EGLR 175, a third has stated categorically that it may not in *BFG Bank AG v Brown and Mumford Ltd* [1995] EGCS 21.

The second most frequent allegation of contributory negligence against a lender is that of failure to adhere to its own internal lending rules or guidelines, or to act on advice given by its own staff. A defence based on these grounds has proved successful on four occasions in *South Australian Asset Management Corporation v York Montague Ltd* [1995] 2 EGLR 219; *BNP Mortgages Ltd v Key Surveyors Nationwide Ltd* (1994, unreported); *Platform Home Loans Ltd v Oyston Shipways Ltd* [1996] EGCS 146 and *Chelsea Building Society v Goddard & Smith* [1996] EGCS 157.

In several cases, valuers have based a defence of contributory negligence on an allegation that the basic lending policy of the particular lender is one which no prudent and reasonable lender would adopt. Such an allegation (relating to the practice of "non-status" or "self-certification" loans) has been specifically rejected in *Bank of Scotland v WG Edwards* (1995) 44 Con LR 77. In *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd* [1995] 2 All ER 769, [1994] 2 EGLR 108, a lender was also absolved of negligence in agreeing to advance 90% of the valuation of a commercial property (of which the top 20% was subject to mortgage indemnity guarantee insurance). However, in what may prove to be an important recent development, a lender was held contributorily negligent in *Platform Home Loans Ltd v Oyston Shipways Ltd* [1996] EGCS 146 by adopting a loan-to-

valuation ratio of 70% in relation to a high-value residential property (which was regarded by the court as especially difficult to value accurately).

The most controversial basis for a defence of contributory negligence consists of an assertion by a valuer that a reasonable lender would not have placed unquestioning reliance on the valuation which was provided. This is controversial because it suggests in effect that a client who has taken and paid for specialist professional advice may remain under some obligation to subject that advice to critical scrutiny and not simply to act upon it. Taken to its logical conclusion, the effect of such a proposition is that, the more negligent the valuation, the more likely the valuer is to evade part at least of the liability for it. Ironically, this is precisely the ground on which the first two successful pleas of contributory negligence in lender-valuer actions were based (*Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd* [1995] 2 All ER 769, [1994] 2 EGLR 108; *Nyckeln Finance Co Ltd v Stumpbrook Continuation Ltd* [1994] 2 EGLR 143), and has now been successful again in *Barclays Bank plc v William H Brown Ltd* [1996] NPC 184 and *Interallianz Finanz AG v Independent Insurance Co Ltd* [1997] NPC 89. In respect of commercial property, these four cases represent four out of the only five cases where contributory negligence has been successfully pleaded.

The final observation to be made from an analysis of the incidence of reported and unreported cases is that there appears to be no instance of a defence of contributory negligence being based upon the fact that the lender accepted a valuation commissioned by the borrower, not the lender. This presents a clear danger of conflict of interest or even fraud and this aspect is expanded upon in Section 4 of this paper.

4. Issues Arising from an Analysis of the Mainland European and the one other Overseas Lender Cases

The previous sections of this paper have investigated the market context, analysed the incidence of cases and identified sucessful grounds for pleas of contributory negligence. However, as this research is aimed at the process of lending in overseas markets, more detailed analysis of the cases involving overseas lenders, mainly European, was undertaken. This more detailed investigation immediately reveals that UK courts have made no allowance for the special position of overseas lenders. In *PK Finans International (UK) Limited v Andrew Downs & Co Ltd* [1992] 1 EGLR 172, no allowance was made in either the standards expected of the lenders or the standards demanded of a valuer acting for them.

More detailed analysis identified three issues which are examined below. Other issues were also identified but are not any more relevant to overseas lenders than to domestic lenders and are therefore outside the scope of this paper. The three issues have not all been listed in Table 5 as successful grounds for a defence of contributory negligence, as they have not all been discussed within the judgments, or even identified as being a problem.

The three issues are the lack of clarity in roles and relationships between lenders and their professional advisors, the element of confusion in communication and division of responsibility within the lender organisation and the lack of ability to interpret or use the professional's advice.

4.1 Lack of clarity in roles and relationships between lender and advisor

Reference was made in Section 1 to the reporting of related studies in which two of the authors have been involved (Crosby, et.al., 1997a; 1997b). One of the conclusions of that work was that it is desirable to ensure that the consultants responsible for producing the valuation utilised by the lenders were wholly independent of the prospective borrower. To put it simply, banks should

commission their own valuations, and not rely upon any valuation prepared by anyone not instructed by them, certainly not one commissioned by a party with a potentially conflicting interest, such as a borrower. Of the five UK lenders interviewed, four invariably instructed the valuer. The fifth would accept a valuation from one of its panel valuers. Of the four overseas lenders interviewed, two would accept valuations from other parties.

It is not necessary to subscribe to conspiracy theory in order to suggest that this is a potential cause for concern. The French bank BNP may have been unsuccessful in actually proving fraud against the valuers who had been working with the owner of the property and who had by letter confirmed a valuation to them in *BNP Mortgages Ltd* v *Goadsby and Harding* [1994] 2 EGLR 169, but they might profitably reflect upon the wisdom of using in such circumstances a valuer whose performance was described by the judge as follows:

> "whilst he was prepared to make statements which were not true in order to exculpate himself from a charge of negligence, the plaintiffs have not satisfied me that at the time he had no honest belief in giving the figure that he did....The fact that he cut many corners, e.g. failing to visit the site, failing to ascertain the sale position of units 3 and 4, the failure to ascertain the then asking prices for the unsold units and the fact that almost contemporaneously he was reflecting the depressed state of the market in (another) valuation are all factors from which a dishonest belief could be determined. Indeed as a paper exercise it may be that I would make such a finding. But the overwhelming impression I had of him in the witness box was of a man who had no intention of acting dishonestly but who did unfortunately show unusual negligence."
>
> (per Judge James Fox-Andrews QC).

One of the most celebrated examples of losses sustained by an overseas lender in the UK property market crash was in *Banque Bruxelles Lambert SA* v *Eagle Star Insurance Co* [1995] 1 EGLR 129 where a whole series of large loans were made on the security of commercial properties valued by consultants John D Wood, on the instructions of the borrowers.

Banque Bruxelles found themselves in the extraordinary position of trying to argue that a contract had existed between themselves and the consultants. While the absence of a contract would not negate the possibility of a duty of care being owed in tort, it cannot have been lost upon the bank that, if they had instructed their own valuers, they would have been in the position for which they were contending so vigorously. Indeed, so far were the lenders from knowing what was going on in the case, namely the approach by an intermediary acting for the borrower to seek 'armchair valuations' from a succession of valuers and submit the highest of these to the lender, that Phillips J held that the lenders would have been guilty of contributory negligence in lending had they had that information. There is some irony in observing that they were too much in ignorance of how the valuations had been commissioned to make possible the defence of contributory negligence.

Nor is the instruction of valuers for loan purposes the only example of relationships where overseas lenders have proved vulnerable. In the case of *Nyckeln Finance Co Ltd* v *Edward Symmons and Partners* (1995) unreported, the Swedish finance institution advanced £3.5 million to a company with £100 share capital controlled by a Mr Shiraz Kassam and his wife, on the security of a development site which was already the subject of a first charge. When Mr Kassam's company defaulted, the property was valued at much less than the amount of the first charge.

Nyckeln's UK Managing Director Mr Tanner had retained Mr David Stokes as a consultant to seek loan business. This resulted in a confusion of the relationship between the valuers who valued the site and Nyckeln. It was contemplated that:

> "Nyckeln itself would make contact with the surveyor to inform him what precisely it was that Nyckeln required."

This appears on page 11 of the judgement. Yet by page 16 there is reference to a letter from the borrower to the valuer which states that:

> "David Stokes arranged with you to send a letter of valuation regarding (the site)."

This letter, from borrower to valuer, ends with the ominous words:

> "As you are aware, your figures are much lower than I think the property is worth and at present, we do not want to use the valuation."

Mr Kassam, it appears from page 17, had arranged for the valuer to undertake a valuation, a copy of which had been sent to the lenders. Mr Kassam certainly instructed Edward Symmons, the defendants in the case:

> "No one on behalf of Nyckeln gave any instructions to Symmons in relation to the valuation of the Property. The instructions given were given by Mr Kassam."

Nyckeln appears to have relied upon Mr Stokes, whose remuneration was determined by the deals he could broker, to protect its interests. The inadvisability of allowing such a person to intervene in the instruction process becomes apparent from the judge's conclusions:

> "The ineptitude displayed by Mr Stokes and Mr Tanner in relation to the loans to Meadrealm on the security of the property almost defies belief....I did not form the impression that either was as grossly incompetent as his behaviour in relation to the loans to Meadrealm would suggest.......it seemed to me that it was far more likely that each consciously disregarded his duty to Nyckeln in relation to the loans to Meadrealm in order to confer benefits effectively upon Mr Kassam.... Although I harbour very strong suspicions, I do not think it right.... to condemn either Mr Stokes or Mr Tanner as dishonest."

Nyckeln did not presumably feel vindicated in their use of Mr Stokes in such an equivocal role by the Judge's finding that he was:

> "merely incompetent in high degree."

The point is that neither he nor the borrower should have been involved at all in the process of procuring valuations upon which the security for the loan was to be assessed.

That Nyckeln's lack of appreciation of this point was not an isolated instance can be established by reference to their most spectacular reported loss: *Nyckeln Finance Co Ltd* v *Stumpbrook Continuation Ltd* [1994] 9433 EG 93. They here lent £21 million on a valuation of £30.5 million in May 1989, an office block which eventually had to be sold in July 1992 for £3.1 million. The purchase, by two Swedish investors, was carried out through a Dutch company formed by one of them. It was he who commissioned the valuation from Jackson-Stops and Staff (JSS - later Stumpbrook). An approach to Nyckeln by a (Swedish) third party persuaded Nyckeln to reconsider their refusal to lend. The judgement of Judge Fawcus records the stark result. Nyckeln:

> "agreed to lend £21 million after receiving a faxed copy of the JSS valuation, ie 70% of valuation."

This turned out to be a valuation of a property in respect of which the expert evidence was that the highest non-negligent valuation at the material time would have been £23.5 million. The lenders were no doubt reminded by the evidence given in the trial that lending by Nyckeln was only to be:

> "against satisfactory security which has been valued professionally by an independent and qualified valuer."

It is submitted that the lenders may have regretted lending at the instance of a third party in reliance upon a valuation carried out on the instructions of one of the principal borrowers.

As the information from the lender interviews is that overseas banks seem less concerned about the source of instructions of valuers and overseas lenders figure prominently in the cases discussed

above, this examination of the dangers apparent in not clarifying the relationship between lender and valuer seems particularly pertinent to lenders operating in overseas markets.

4.2 Confusion in communication and responsibility within the lending organisation

A second notable feature of the lender-valuer case law is the extent to which, in disputes involving overseas lenders, the lines of communication and divisions of responsibility within the lending organisation itself have tended to become unclear and a source of confusion. This, it should be said, appears to relate exclusively to loans on commercial property. To judge from the cases studied, the practice of overseas lenders operating within the UK residential sector is to devolve upon their local branch full decision-making responsibility (perhaps because the size of each individual transaction is comparatively modest).

By contrast, lenders operating in the commercial property market frequently insist that the final decision on any given loan is taken at head office (ie in the home country). The functions of the UK branch in such circumstances are restricted to making a recommendation as to a particular loan (often in respect of business which the UK branch has expended considerable effort to obtain), and to provide technical support for that recommendation in the sense of obtaining a valuation of the proposed security, carrying out a credit check on the borrower and so on. These latter functions are commonly required to be carried out within parameters set by head office in the form of lending rules or guidelines.

The methods adopted within the commercial sector have caused problems in two particular respects. The first is that the procedures or guidelines laid down by head office are not always as well understood as they might be by those whose responsibility it is to implement them at the local level. In *PK Finans International (UK) Limited v Andrew Downs & Co Ltd* [1992] 1 EGLR 172, for example, the plaintiff bank did not appreciate that the valuation of a proposed development was based upon certain planning assumptions which had not been verified. In holding the bank at fault

for not showing the valuation to its solicitors (who would undoubtedly have checked the planning position), the judge said that:

> "the plaintiffs' procedures left much to be desired, in that there appeared to be uncertainty about who should process matters and there being an absence of a recognised procedure for doing so".

It may not be unreasonable to suggest that a UK lender would have been all too well aware of the need to lay down a procedure which would:

> "have stated precisely what should have been done, which would have included sending the valuation to the company's solicitors".

An outstanding example of confusion between head office and local branch on the subject of guidelines is provided by *BFG Bank AG v Brown and Mumford Ltd* [1995] EGCS 21. Here the member of the bank's London office who was handling a particular loan, had virtually no knowledge of German, the only language in which the bank's lending criteria were published. Not only that; the guidelines:

> "were prepared and relate to the German situation in law, in particular as to planning and so on".

[An interesting contrast is given by *South Australian Asset Management Corporation v York Montague Ltd* [1995] 2 EGLR 219, where the bank's London office produced its own property lending policy (which it did not in fact comply with in the particular case); this was unique to London, and the decision-makers at head office in Adelaide had never seen it.]

The second way in which the division of responsibility between head office and local (UK) branch has caused problems is more subtle. There is some evidence of a danger that, once a proposed loan has received head office's approval in principle, a local branch may treat its responsibilities as

routine or trivial and may fail to meet standards of normal banking prudence. In such circumstances the task of thoroughly checking a proposed loan may fall between two stools. For example, in *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd* [1995] 2 All ER 769, [1994] 2 EGLR 108, the plaintiffs' head office gave its London branch authority (known as the "enveloppe") to establish a £100m (later increased to £200m) portfolio of insurance-backed loans on commercial property, subject to strict conditions. It was London's responsibility to ensure that the conditions of the enveloppe were satisfied and that the individual transactions were otherwise satisfactory, since:

> "only the London office could judge the quality of a real estate project in London, the quality of the valuers, the quality of the London market".

However, the judge clearly felt that, once granted the enveloppe, the London office proceeded on the basis that the risk analysis had already been undertaken and that:

> "all that was required was to ensure that the transactions fell within the structure of the enveloppe and the financial limits of their authority".

This limited view of their task led the London office to abandon their normal careful procedures:

> "The proposals were never submitted for credit analysis and the account officer's consideration and presentation were perfunctory ... they never applied a rigorous critical analysis to the transactions once their full details, and in particular the purchase prices, became known".

A similar down-grading of responsibility by local officials may be seen in *Nyckeln Finance Co Ltd v Stumpbrook Continuation Ltd* [1994] 2 EGLR 143, where, as set out in the previous section, a potential borrower made a direct approach to the plaintiffs' head office in Sweden, armed with a valuation of £30.5m, and received an offer "in principle" of a loan of £21m, to be processed through the plaintiffs' London subsidiary. A senior employee of the London company was sufficiently uneasy about the valuation to obtain and to pass on to head office informal opinions from two respected valuers of his acquaintance (that the property was worth between £21m and £23m). He

also questioned the person responsible for the original valuation but, although feeling that he had not received a satisfactory explanation:

> "did not feel that he had further grounds for going back to [head office]"!

Not only did this overseas lender accept a valuation commissioned by the borrower, it also suffered from the lack of communication between head and branch offices.

4.3 Interpretation and use of consultants' advice

It has already been pointed out in the preceeding section that language may on occasion literally be a barrier in trying to relate advice to a lending decision. In the case of *Nyckeln Finance Co Ltd* v *Edward Symmons* [1995] Unreported, it appears that language was not the only bar to understanding by the lenders of the significance to be attached to valuation reports. The lenders appear to have sought to rely upon the valuation figure without feeling the need to assimilate the exploratory text of the report, despite the limitations of pricing valuations in the lending process (Crosby, et.al., 1997a). They alleged that:

> "in effect, the client was entitled simply to look at the stated valuation figure and to ignore the remainder of a valuation report as mere verbiage."

The view of Richard Seymour QC presiding was that the lender was not entitled to presume this. The lenders had been wrong in seeking to place reliance upon a figure in isolation:

> "it is not negligent for a valuer who explains in his report what he has done, and what assumptions he has made, to put forward a valuation, even if such valuation was undertaken on bases which no reasonably competent valuer would have adopted."

This was the crux of the case and the principal reason why the lenders were unable to recover against the consultants:

> “a reasonably prudent lender reading the Report would have understood, as Mr Stokes did.... that the critical premise upon which the valuation of Scheme 2 was based was that the Scheme was successfully completed. A reasonably prudent lender would certainly not have relied upon the Report as a valuation of the Property in its existing, unimproved condition.”

It was mentioned in Section 4.1 above that *in Nyckeln Finance v Stumpbrook Continuation Ltd* the lenders had responded to a faxed valuation from valuers they had not instructed by lending £21 million to a Dutch company set up for the purpose of purchasing the subject property. The lender’s reliance on the valuation is almost touching in its simple faith. The Swedish banker, Mr. Palmstierna of Nyckeln:

> “did rely on the valuation because he knew of JSS as a reputable firm, who were on the (lender’s) panel of approved valuers”

They did so although or perhaps because:

> “there was no one within the group in Sweden who had a background in property or who could hold himself out as a specialist in London commercial property.”

Even allowing for Judge Fawcus’ endorsement of the view that:

> “ it lies ill in the mouth of a professional valuer, who is giving a valuation for mortgage lending purposes, to say that it was unreasonable for the party to whom such valuation was given to rely on it”;

the lenders were hopelessly ill-equipped to interpret and use properly the valuation faxed to them.

There seems also little doubt that overseas lenders were slow to ask appropriate questions about apparent discrepancies between valuation reports and the evidence available to them. The Belgian lenders in *Banque Bruxelles Lambert* v *Eagle Star Insurance* [1994] 2 EGLR 108 failed to query the substantial differences between purchase prices and valuations and were accordingly held to be

contributorily negligent. In other words, the lenders were not entitled to rely blindly upon the valuers' figure. It must be said that overseas lenders did not in the structured interviews show themselves to be less willing to query the valuation figure than their UK counterparts. There is evidence, however, that the overseas lenders themselves are not happy with the quality and usefulness of advice they receive in valuation reports. Whereas four of the five UK lenders were satisfied with the contents of their reports, three of the four overseas lenders were not.

There may be some evidence of a lack of appreciation of the professional status of the consultants who report to the overseas lenders. Two of the four overseas lenders interviewed did not insist on using RICS valuers, which would be an elementary requirement for most UK lenders.

5. Conclusions

The principal conclusion of this paper is that lending institutions undertaking property loans abroad are in some key respects more exposed to risk than lenders operating in their own countries. Despite being responsible for a minority of lending to property companies in the 1990s, overseas lenders have been found (or would have been found) to contribute negligently to losses made in the UK property market in eight cases out of a total of only 12. Seven of these overseas lenders were from mainland Europe

Some of the reasons for this exposure, such as general differences of culture and attitude, may also be common to other types of lending. However, this research has identified the major grounds for sucessful pleas of contributory negligence by lenders, which are failure to adhere to own lending policy or procedures, inadequate checks on the borrower, unquestioning reliance on the valuation and imprudent lending policy. The analysis of cases indicates three issues which have proved in the past and/or could prove in the future especially harmful to the interests of overseas lenders in the UK property market.

First, they may lack an understanding of the sources of advice and the legal relationship which can best protect their interests. It is submitted that ample evidence has been adduced of confusions of roles and relationships and an ignorance of where and by what means independent valuation advice can be obtained. The dangers of accepting valuations commissioned by the borrower rather than the lender are fully illustrated in a number of cases and there is evidence to suggest that overseas lenders are more inclined to accept this situation.

Second, overseas banks appear to have suffered frequently from a lack of clarity in the lines of communication within their own organisations. This is true of members of the lending institution trying to apply lending policies and it is true of communications between overseas branches (e.g. in the UK) and the head office in the home country.

Third, there is a genuine lack of understanding of the use which can probably be made of loan valuations and the extent to which they form part of the lending decision. There may be some uncertainty in the law in this respect but the lender is not entitled to rely solely on the valuation figure, without testing it against other information in the report. The limitations of a single snapshot in time pricing valuation are well documented and the additional information in valuation reports is essential to put it into context. There is evidence to suggest that some overseas lenders are ill-equipped to assimilate this advice and have relied on the valuation figure without the context.

While it would be unsafe to extrapolate prescriptively from the UK experience, because different cross-border transactions will raise different problems, in one sense this is one of the points of the paper. Different legal and land use planning regimes, different markets and different professional structures and traditions should call for an approach which is distinct from, but no less rigorous than, the approach taken domestically in property lending. In the eyes of the courts, all lenders are equal, regardless of being home or overseas organisations.

Lending institutions, when entering overseas markets for the first time, should undertake preliminary studies of how to obtain the necessary independent expert advice which is necessary for an informed lending decision. Potential conflicts of interest require special forethought. Lines of communication will need to be well planned, so that information is conveyed to those capable of using it in the context of established lending policy. The personnel to whom it is directed must be capable of understanding what the valuation (and other advice) does, and what it does not do (i.e. the limitations). Although they must wish to avoid a poor lending decision, lenders must also be aware of the consequences of making one.

A lack of detailed information on the institutional context and legal framework of the country in which the investment or lending is to take place constitutes an investment risk. A lack of knowledge

on the possibilities and pitfalls of attempting to recover damages from professionals employed in that market is one such information deficiency.

However, if overseas lenders are to avoid the problems isolated by this analysis of cases decided in the UK, they need to respond positively to these issues. The evidence of the interview survey of overseas lenders discussed previously suggests that not all these proposals are adopted and that not all the lessons that could be learnt from their losses in the 1990s have been assimilated.

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