THE STATE OF THE MARKET

Across the U.K. professional indemnity (PI) insurance market as a whole, insurers are currently operating on the leanest of margins. Fueled in part by the economic downturn, an increasing frequency of claims has pushed insurers’ loss ratios close to or beyond the 100 percent mark, leaving many PI accounts in the red. Nevertheless, with attractive investment opportunities notably thin on the ground elsewhere, the insurance market globally remains awash with capital, unleashing strong downward pressure on rates as insurers compete to deploy their capacity.

As a result of this pressure, rates across the PI market are generally close to record lows. There are, however, one or two significant exceptions to this rule, where specific fears of soaring claims activity have forced insurers to insist on higher premiums or to withdraw from offering cover altogether. One of these exceptions relates to surveyors undertaking valuation work.

If a lender incurs losses due to a proven overvaluation, it should of course be entitled to compensation for those losses to the extent that they result from the surveyor’s negligence. Some lenders appear inclined, however, to seek to rely upon surveyors’ PI policies as a kind of product guarantee, even in the absence of any clear evidence of negligence on the part of the surveyor. If
the value of a property falls following valuation, such a lender may prefer to bring a speculative claim against the surveyor, alleging overvaluation, rather than accept the commercial loss without challenge. Such claims can rarely be disposed of easily and, regrettably, some will inevitably succeed.

Since 2007, corporate surveyors operating in the mortgage lending market have received an increasing number of claims from lenders seeking to recover losses resulting from falling property values. There was evidence through the summer of 2011 to suggest that the volume of such claims may have peaked, but recent experience suggests otherwise. It is notable, in particular, that claims alleging negligent overvaluation emanate primarily from the subprime market and not the main high street lenders.

Securitisation has been utilised extensively by lenders in recent years, particularly those operating in the subprime market. The surveyor’s signed declaration on the valuation pro forma usually permits the client lender to assign and transfer rights in the mortgage with no limit or restriction on the number of transfers. Consequently, claims are often made by SPVs or other parties that were not the client of the surveyor.

Contribution claims are also on the rise, whereby the insurers of defendant solicitors bring claims alleging contributory negligence against surveyors.

It is an unfortunate feature of lender claims against surveyors that they are frequently brought under conditional fee agreements (CFAs) or with the benefit of an after-the-event insurance policy (ATE), both of which increase the liability costs dramatically for an unsuccessful defendant surveyor. The risk of failing to successfully defend a claim in the face of a CFA/ATE is a major tactical consideration, particularly when assessing the economics of defence.

Although claims arising from work completed at the height of the market are now increasingly becoming time-barred under the relevant primary limitation periods, claimant lenders are still seeking to avail themselves of the latent damage provisions of the Limitation Act in order to pursue claims.

There have been no instructive court decisions since the last recession concerning the degree of contributory negligence attributable to the lender in surveyors’ valuation claims. It is prudent to assume that, whilst the current economic turmoil lasts, surveyors will continue to experience a high volume of claims, particularly those surveyors operating in the high-volume valuation field.

Four notable legal cases involving surveyors include:

- **K/S Lincoln v. CB Richard Ellis Hotels 2010**
- **Capita v. Driver Jonas 2011**
- **Scullion v. Bank of Scotland 2011**
- **Hambros v. Weatherall Green 1997**

It is also worth touching upon the cases of **Platform Funding Ltd v. Bank of Scotland**, and **Merrett v. Babb**, both of which have been well documented over the years. A slightly more in-depth review of the facts involved in the judgment and conclusions for each case can be read in the case studies section at the end of this paper.
A degree of moral hazard clearly exists when lenders perceive an opportunity to pass on the risk of falling property values to surveyors and their insurers. As things stand, however, financial institutions have every incentive to exploit this line of approach and little disincentive. This has led insurers to review their books of surveyors’ PI business very carefully and has encouraged a number to withdraw altogether from covering those surveyors that provide valuation services.

The bare half-dozen insurers still active in this market have pushed rates up by as much as 200 percent over the past year for firms heavily involved in valuation work. Rising PI insurance premiums are the last thing such firms need at a time when they are already seeing business volumes and revenues severely affected by the depressed property market. Larger firms, for which valuation represents only a small part of their work, are likely to be less severely affected by rising PI premiums, depending on their recent claims profile.

Another problematic area which has come to the fore as a result of the economic downturn is mortgage fraud. Claims for mortgage fraud always increase in times of recession. The number of such claims by lenders shot up—more than doubling—between 2007 and 2008 as the current crisis set in. As one would expect, insurers are now seeing an increased level of losses resulting from fraud claims brought against property developers, surveyors, and their legal advisers. Mortgage fraud is perceived as being perpetrated widely by loan applicants assisted by brokers. We have seen little evidence, however, of brokers who have acted fraudulently being included in claims. There is anecdotal evidence of organised crime operating in the property market leading to significant lender losses. In June 2011, one former valuer, Ian McGarry, was sentenced to seven years in prison for his part in a mortgage fraud worth £49 million, having been found to have accepted bribes worth an estimated £1.2 million from property developers to provide “optimistic” valuations, which were subsequently used to secure around £50 million in loans from financial institutions, £26 million of which ended up in bank accounts overseas.

Another less spectacular but increasingly familiar form of fraudulent activity causing concern to valuing surveyor firms and their insurers involves the practice of switching numbers between flats of differing value within residential blocks to secure an inflated valuation. Lockton has received notification of a number of potential claims involving this type of fraud in recent months, and it is something insurers are bound to be keeping a wary eye on. The key concern here is that, regardless of whether the surveyor has employed all reasonable skill and care to value the right property, the law as it stands imposes strict liability on the valuer.

All of these factors are contributing to a heightened level of caution among insurers. One outcome of this is that surveyor firms are facing increasingly detailed requests for information from their insurers. Collating all of this additional information can prove burdensome, so Lockton would strongly advise surveyor firms to begin the renewal process sooner rather than later. This should ensure there is plenty of time available to resolve any more complex issues that may come to light.
For surveyor firms not undertaking valuation work, rates remain highly competitive, and this is still very much a buyer’s market. The recent arrival of insurers such as Allianz, Amtrust, Starr, and Torus has only served to increase competition for property surveyors outside the valuation market and for construction sector surveyor firms.

How long can we expect the current soft market to endure? Barring major changes in the broader global economy, it will probably take a significant shift in the pattern of claims to turn the market. Past experience, however, strongly suggests that, once the market does turn, it can move remarkably far and fast. This highlights the value of building stable long-term relationships with insurance carriers, who will then be more amenable to help smooth the curve of rising premium rates.

Sound risk management is also key to keeping premiums down. Underwriters look for evidence of an established risk management infrastructure as one of their key decision-making criteria. Mitigating potential risks will also help maintain a good claims record. As well as keeping professional services firms updated through regular newsletters, Lockton can play a valuable advisory role in establishing and maintaining a sound risk management regime.

**CASE STUDIES**

1. **K/S Lincoln v. CB Richard Ellis Hotels 2010**

**Headline:**

Ten percent margin of error applied. Valuers can be liable even if the margin is right and clients request specific work or information.

**Facts:**

Danish investors (K/S Lincoln) through a scheme bought four budget hotels in the U.K. The scheme bought each hotel subject to a lease for a term of 25 years containing turnover rent provisions.

CB Richard Ellis were expert hotel valuers who acted for a variety of parties with an interest in these and four other related properties. The scheme instructed CB Richard Ellis to provide valuations of the four hotels. These valuations included forecasts of when the hotels would generate a rent surplus.

Investors in the scheme did not prosper as they hoped. They sued CB Richard Ellis for failing to value properly the effect of the turnover rental provisions, which was to delay an increase in rent for several years. They also sued CB Richard Ellis for the overvaluation of the capital value of the hotels.

**Judgment:**

The judge held that CB Richard Ellis did owe a duty of care in respect of the turnover rent provisions. Valuers owe a duty of care in respect of the statements in their report not just for the valuation. CB Richard Ellis
breached that duty by not including the turnover rent provisions in their forecasts of when the hotels would generate a rent surplus. The scheme had, however, fully understood the effect of the turnover rent provisions as they demonstrate in their correspondence. Therefore, the breach of duty of care did not cause the loss to the investors.

Secondly, the overvaluation of the capital value of the hotels was within the permissible margin of error of 10 percent. Therefore, regardless of errors in their methodology, CB Richard Ellis were not liable.

**Conclusion:**
The conclusion to draw from this is the margin of error was set at 10 percent. The judge put this as a general guide, remarking that this could stretch to 15 percent or higher in specific cases. Valuers can take some comfort from this. However, it is important to remember that specific requests can create a liability even where the valuation is within the margin.

2. **Capita v. Driver Jonas 2011**

**Headline:**
£18.5 million damages. 10 percent margin of error applied. How not to do it.

**Facts:**
Capita acting as the trustee of an Enterprise Zone property unit trust (EZPUT) acquired the lease of a factory outlet centre in Kent for £62.85 million. Drivers Jonas prepared a valuation report that gave the open market value of the factory outlet centre as £48.15 million or £62.85 million with the enterprise zone allowances. The factory outlet centre was not a commercial success. Capita, with others, sued Drivers Jonas for negligently failing to assess the factory outlet centre’s ability to attract consumer spending and overvaluing the rent per square foot at £27.50. This meant the whole venture was overvalued.

**Judgment:**
Drivers Jonas had a duty of care to Capita and the EZPUT both in contract and in tort. They did not have the experience or expertise necessary so breached their duty. By failing to prepare or obtain a CACI or CACI type report, which was the standard practice they breached that duty. The figure of £27.50 per square foot was not properly calculated. An appropriate figure would have been £19 per square foot. A competent valuation for the factory outlet centre would have been between £31.955 million and £36.795 million. Therefore, this was well outside the 10 percent margin for error and Drivers Jonas were in breach of their duty and negligent. Capita were due the gap between what they would have paid, £44.8 million, and what they paid due to Drivers Jonas’s negligence, £62.85 million, which came to £18.05 million.

**Conclusion:**
Here the margin of error applied again, but the valuation was not even close. The methodology came under scrutiny, and the judge saw major gaps from standard practice. The large sum awarded shows just how big the impact can be.
3. **Scullion v. Bank of Scotland 2011**

**Headline:**
Decision reversed. Now no duty of care between bank’s surveyor and buy-to-let investor.

**Facts:**
The first decision held that a bank’s surveyor owed a duty of care to a buy-to-let investor in the same way as they do with a domestic householder.

**Judgment:**
The Court of Appeal reversed the previous decision because, unlike the 90 percent of domestic householders who rely on the bank’s surveyors, buy-to-let investors are making an inherently commercial decision. This means they should have both the knowledge and the financial capability to make their own decision or obtain their own valuation.

**Conclusion:**
The widening of the valuer’s duty of care has been clearly closed. The decision shows how the court puts emphasis on the commercial situation.

4. **Hambros v. Weatherall Green 1997**

**Headline:**
Valuing the wrong thing.

**Facts:**
Hambros sued Weatherall Green for valuing four hotel leases on a going-concern basis rather than an open-market valuation with vacant possession as they requested. The consequence was when one of the tenants failed to meet the terms of its lease, the insurance company would not pay the full valuation. Hambros sought the amount up to the full valuation from Weatherall Green.

**Judgment:**
The judge held that Hambros had, it appeared, asked for a valuation as a going concern. If this was not right, then, in any case, the sending of a draft report making clear the valuation was as a going concern by Weatherall Green gave Hambros the opportunity to correct the error. Hambros made no adverse comment, so Weatherall Green was entitled to assume their valuation method was correct and therefore were not negligent.

**Conclusion:**
This highlights the importance of being clear about which methodology is used, understanding what the client asked for, and being explicit about the valuation delivered.


**Headline:**
The duty of care is personal to professionals. This means where other sources of compensation are not available then employees can be personally pursued for negligence.

**Facts:**
Miss Merrett and her mother bought a house. The mortgage lender instructed Clive Walker Associates to inspect the property and prepare a report. The property was surveyed by Mr. Babb, a salaried employee of Clive Walker Associates.
The report was negligent. It failed sufficiently to notice and report on settlement cracks between an original building and a later extension. Clive Walker went bankrupt, and his trustee in bankruptcy cancelled the PI insurance (contrary to the Professional Indemnity Regulations of the Royal Institution of Chartered Surveyors).

Miss Merrett sued Mr. Babb personally. The judge at first instance found that Mr. Babb owed Miss Merrett a duty of care. He based this on the decision of the House of Lords in *Smith v. Eric S. Bush* and *Harris v. Wyre Forest District Council* [1990] 1 AC 831.

Mr. Babb appealed to the Court of Appeal.

**Judgment:**

The Court of Appeal held that Mr. Babb did owe a duty of care in his personal capacity as a Chartered Surveyor. This was because he, as a professional man, realised that the purchaser was relying upon him to exercise proper skill and judgment in his profession and that it was reasonable and fair that the purchaser should do so. Miss Merrett and her mother did not know who had carried out the valuation. The judge had no doubt though that they relied on the professional skill and care of the individual person (Mr. Babb) who carried it out.

The Court of Appeal regretted that Mr. Babb was uninsured, but this was not relevant to their decision.

**Conclusion:**

There are two conclusions from this case. Firstly, never forget your professional duty is a personal one. This is not new law but emphasises how you must always be aware that you are liable for your professional actions.

Secondly, practical steps should be taken to avoid being exposed to that personal liability. Consider your own exposure particularly through:

- Former employers whose insurance may lapse through insolvency or retirement.
- Late notification of claims that invalidate insurance (or other policy non compliance).
- Insufficient cover by your employer.


**Headline:**

Commercial unqualified obligations can be present in addition to the professional duty of care.

**Facts:**

A Schedule 1 surveyors report was requested for a property that was to be security for a loan.

The property was 1 Baker’s Yard. The surveyor contacted the owner, Mr. Hewes, and met him at what he believed to 1 Baker’s Yard. In fact, it was 5 Baker’s Yard, and he had been deceived by Mr. Hewes.

Through a complicated appointment, the report was “retyped” and submitted as part of the documentation to Platform, who were not the original funder. The report contained a declaration that it was for Platform and that “the property offered as security has been inspected by me.”
The loan inevitably went sour, and the surveyor was sued for breach of contractual warranty. There was no allegation that the surveyor had not used all reasonable skill and care. The judge at first instance awarded damages to Platform.

**Judgment:**
There was no negligence as none had been alleged. The Court of Appeal held that the common sense view prevailed “that the inspection of the wrong property, like the painting of the wrong portrait, or the photographing of the wrong wedding, is a straightforward breach of retainer and contract, and one which does not depend on the taking or absence of reasonable care.”

“In other words, the normal retainer is that the surveyor undertakes to inspect and value the property he has been instructed to inspect and value, and also has to carry out that inspection with reasonable care.”

**Conclusion:**
Firstly, timely reminders to check you are reporting on the correct property. Could an allegation of negligence have succeeded here?

Secondly, the professional duty is simply to take reasonable skill and care, but other contractual obligations easily arise and have to be fulfilled.

**Case studies courtesy of Alan Stone and Richard Moody at Reynolds Porter Chamberlain LLP.**